

ADMINISTRATION'S ENERGY TAX PROPOSALS

F 49: S. HRG. 103-215

Administration's Energy Tax Proposa...

HEARINGS
BEFORE THE
COMMITTEE ON FINANCE
UNITED STATES SENATE
ONE HUNDRED THIRD CONGRESS
FIRST SESSION

APRIL 20 AND 22, 1993



DEC 1 1993

Printed for the use of the Committee on Finance

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ADMINISTRATION'S ENERGY TAX PROPOSALS

TUESDAY, APRIL 20, 1993

**U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, DC.**

The hearing was convened, pursuant to notice, at 10:10 a.m., in room SD-215, Dirksen Senate Office Building, Hon. Daniel Patrick Moynihan (chairman of the committee) presiding.

Also present: Senators Baucus, Boren, Bradley, Riegle, Daschle, Breaux, Conrad, Packwood, Roth, Danforth, Durenberger, Grassley, Hatch and Wallop.

[The press release announcing the hearing follows:]

[Press Release No. H-12, April 8, 1993]

FINANCE COMMITTEE TO REVIEW ENERGY TAX PROPOSALS

Senator Daniel Patrick Moynihan (D.-N.Y.), Chairman of the Senate Committee on Finance, announced today that the Committee will hold two hearings on the Administration's energy tax proposals.

The hearings will begin at 10:00 a.m. on Tuesday, April 20 and Thursday, April 22 in room SD-215, Dirksen Senate Office Building.

Treasury Secretary Lloyd Bentsen will testify at the April 20 hearing.

OPENING STATEMENT OF HON. DANIEL PATRICK MOYNIHAN, A U.S. SENATOR FROM NEW YORK, CHAIRMAN, COMMITTEE ON FINANCE

The CHAIRMAN. A very good morning to our distinguished guests and Secretary. I am going to ask that the doors be closed and those in the back of the room be quiet or take their leave.

Good morning. This is the first of a series of hearings that the Committee on Finance will hold on the President's revenue proposals.

We have the great honor to have before us our former Chairman, the Secretary of the Treasury, Lloyd Bentsen, and Mr. Lesley Samuels. Mr. Samuels, we welcome you here, sir. You are on that list of persons who is not quite official.

You will be pleased to know we have your FBI report. It is something called the OGE, which is not to ogle, but I believe it is Office of Government Ethics. If they ever get you through, we will confirm you promptly.

Mr. Secretary, may I first say that there was a Republican caucus meeting at 10:00 this morning on large issues that we are facing on the floor this week. I am sure the Republican members will be in here in due course. They are not absenting themselves from this hearing, but they are just participating in another matter at this moment.

Yesterday we learned about the final events in Waco, TX, which began weeks ago with an action by the Bureau of Alcohol, Tobacco and Firearms and led to the stand-off that took place. The new developments yesterday, and the ghastly circumstances, were tragic.

Your Assistant Secretary for Enforcement, Professor Ronald Noble, in whose care falls the Bureau of Alcohol, Tobacco and Firearms, papers have not yet arrived. We were informed this morning by Mr. Ginsburg of the White House counsel's office that they will be here today. That will enable us to hold a hearing Monday, and then we shall have occasion on Tuesday to report the conformation. So you will have an Assistant Secretary soon.

I think it has to be said that you are trying to run the Treasury with only three people who have been confirmed. You have an advantage over Donna Shalala who has only herself. That is beginning to be a problem, which I do not, in fact, need call to your attention. We have spoken with Professor Noble about the ATF, and they obviously have some difficulties. There is a problem of duplication. You have two law enforcement agencies where one might or might not do better.

In any event, sir, I wondered if I could ask if you had any comment you would like to make at this time on the events on the assault on the Branch Devinian Compound in Waco and the subsequent fire and deaths.

Secretary BENTSEN. Yes, Mr. Chairman, I would like to make a comment. Let me state that insofar as those numbers of people confirmed and not yet confirmed, that we appreciate very much the expeditious way in which you and this committee have considered those that have been sent up where all the files have been completed. We are appreciative of that and the fact that you will be seeking Mr. Noble's confirmation on Tuesday would be most helpful to us in the work that has to be done.

I would say that this afternoon that the President of the United States will be calling on the Justice Department and the Treasury Department to have a joint, full and thorough investigation of the incidents in Waco, as to what happened in the beginning and what happened in the ending of that stand-off. And in turn, that that will be reviewed by outside experts for the considerate to see what can be done to divert such tragedies in the future.

The CHAIRMAN. I do not suppose you want to say or ought to say more. But I very much appreciate that, sir.

Senator Packwood, I mentioned earlier that there was a Republican caucus at 10:00 and that my colleagues were not avoiding this hearing but had a scheduling conflict. I am pleased to see you have come, and you are very welcome.

OPENING STATEMENT OF HON. BOB PACKWOOD, A U.S. SENATOR FROM OREGON

Senator PACKWOOD. To which I am told Senator Dole talked to Secretary Bentsen yesterday and indicated the problem, which Senator Bentsen said, gee, I hope none of them come. [Laughter.]

Secretary BENTSEN. I am not sure I was enthusiastic to that degree.

Senator PACKWOOD. I would like to comment on Waco. British television just caught me outside. I know nothing about it other

than what I have read in the press. But I am inclined very much to support the Attorney General. I hope this does not turn into the who is responsible for the surprise at Pearl Harbor investigation.

Based upon the facts that I think she had, I think she acted correctly. She has taken responsibility and I certainly hope it does not turn into a "witch hunt" and we look for some goat to hang for something that I think was properly handled.

Secretary BENTSEN. Senator Packwood, I thoroughly agree with that. I thank you for your comments. I am sure she would appreciate that comment.

The CHAIRMAN. If you do not mind, Mr. Secretary, I think I would like to ask Mr. Baucus and Mr. Bradley for comments.

Senator BAUCUS. On this subject?

The CHAIRMAN. On this subject.

Senator BAUCUS. I have not comment, Mr. Chairman.

Senator BRADLEY. On this subject?

The CHAIRMAN. Yes.

Senator BRADLEY. No comments, Mr. Chairman.

The CHAIRMAN. Very well, sir. We welcome you, Mr. Secretary. We have your written testimony, of course.

Senator BRADLEY. Mr. Chairman, on another subject.

The CHAIRMAN. On the subject of the hearing, yes. Senator Bradley.

OPENING STATEMENT OF HON. BILL BRADLEY, A U.S. SENATOR FROM NEW JERSEY

Senator BRADLEY. Mr. Chairman, I wanted to say to the Secretary and to the Committee that I think we ought to keep our focus on the purpose of today's hearing, which is how do we reduce the budget deficit. The BTU tax which the Secretary will be testifying in support of is simply a means to an end; and the end is reducing the budget deficit.

There is a real imperative in my view that this be done. GAO last year told us that, if we do not reduce the budget deficit, all of our incomes by the year 2020 could be 40 percent less than they otherwise would be.

Nobody likes to pay a tax. As the former Chairman of this Committee used to day, "Don't tax me, tax the man behind the tree." And it applies very directly to this BTU tax. I happen to think that a BTU tax is a reasonably good tax. It is broad-based. It has been phased in. It has positive environmental impacts.

But the key point is that it raises revenue to reduce the budget deficit. If someone does not want the BTU tax, it is incumbent upon them to tell us how they will reduce the budget deficit by the equivalent amount.

I have one last point. My general view is that exemptions and loopholes rarely make any tax fair. I would hope that they could be resisted. I know that there are some provisions that have already been exempted. I think we have exempted ethanol or methanol and varieties of others. It is very difficult to make a distinction between one exemption and others, once you are heading down that slippery slope.

I hope ultimately we will keep that in mind as we hear from the Secretary and also as we deliberate in the Committee.

But the bottom line here is the budget deficit. This happens to be a rather broadly-based and, I think, a fair tax. If there is a better one out there, then the people who are advocating that it should be replaced should make the case why their proposal is better than a BTU tax.

Mr. Chairman, I thank you.

The CHAIRMAN. Thank you, Senator.

Senator Baucus.

OPENING STATEMENT OF HON. MAX BAUCUS, A U.S. SENATOR FROM MONTANA

Senator BAUCUS. Mr. Chairman, I just might add one point. I think all of us generally agree with the Senator's statement. I think though it is important to remind ourselves that we do not live in a homogeneous society. Some sectors of our economy are a bit different than other sectors of our economy. Not every industry is in exactly the same economic situation or the same financial situation, or affected in exactly the same way by the BTU tax. There are differences.

It really means that we as a Committee, the Senate, the Congress, and the administration have to find the right balance between equity and simplicity. A simple across-the-board BTU tax will raise revenue. It will also cause some dislocations in the economy. I think it is only fair that we not wear blinders but we be very sensitive to meritorious claims of inequities and try to deal with them in a fair, reasonably balanced evenhanded way.

Now some will claim that, well, when you start down that road that is a giveaway to some special interest group. That is an easy claim to make and sometimes it is true and sometimes it is not true. But it is up to us to be responsible and to try to judge those claims as they arise and determine which claims are legitimate and which claims are not.

So I think, frankly, the administration is on the right track—the modified BTU tax addresses some of the inequities that were contained in the original version of the administration's proposal. I just hope that we view it with the points made by the Senator from New Jersey in mind. Let's keep this thing on track. But I also think it is only fair that we look at legitimate claims of unfairness and deal with them appropriately.

The CHAIRMAN. Thank you, Senator Baucus.

Senator Conrad, did you wish to speak?

Senator CONRAD. No. I would be happy to withhold.

The CHAIRMAN. Thank you.

Of course, Senator Breaux?

Senator BREAU. I will do the same.

The CHAIRMAN. Thank you.

We welcome you, Mr. Secretary. Would you proceed as you so choose?

STATEMENT OF HON. LLOYD BENTSEN, SECRETARY, DEPARTMENT OF THE TREASURY, WASHINGTON, D.C.

Secretary BENTSEN. Thank you very much, Mr. Chairman. I am very pleased to be invited here to talk about some of the specifics of the energy tax that we proposed. As I listened to the comments

of the two members, I would have much agreement with what has been stated there.

There is no question but when you propose a tax none of them are popular. I do not know of one where a fellow would like to attach his name when you are talking about a tax. And there is no question about how you cannot anticipate how it affects every facet of the economy, and that you should respond to some of those where you think they were meritorious in trying to bring about further equity.

But you do have the problem with what the Senator from New Jersey has said, at what point is it equity and at what time is it responding to some political interest that is seeking more than its share insofar as its application.

I am pushing this one hard because of its significance to our long-term economic health of the country—addressing that deficit and trying to get it down, looking at a situation today where interest charges are 14 percent of our budget, going up to 20 percent. All we get back for that is a cancelled check, nothing to show for it.

If we do not address these kinds of concerns now, our options are going to be lessened in the future. It will be much more difficult to turn this situation around. This energy tax is a very important part of that cut in the deficit. Create the kind of long-term growth to our economy. Create the jobs and the income growth that Americans want.

It also reflects the very clear understanding in the Clinton administration that we just cannot accept the status quo. We have to take some bold steps to try to influence our economy. We cannot view that energy tax in isolation.

Let me tell you why. These deficits that we have been running up so rapidly for over a decade now have been draining that pool of private savings. They have been cutting the rate of capital formation by our industries. They cause us to borrow from abroad.

I sat up there time and time again and tried to push the IRA. Some of my colleagues agreed with that and some did not. But that was trying to increase private savings. But there are two ways to take care of savings and providing capital in this country. One is by increasing private savings and the other is by cutting that national deficit on your budget and that adds to the capital of our country.

So I have chosen to take that course and so has the administration in this instance. In the process of what has happened, we have become the world's leading debtor. That is why the energy tax is important to us, to help us get that deficit down.

Between 1994, when we get the first elements in place, and 1998 when it will have been fully functioning for a year, this tax will have produced over \$72 billion in revenue. That is a significant contribution. In fact, it is one-sixth of the total net deficit reduction in our plan for the years 1994 through 1998.

The first year that this tax is fully phased in, in 1997, it will produce over \$22 billion in revenues. That amount is going to grow over time. This program has won some widespread support in America. I know that not everyone in the energy business agrees with us, that we need this energy tax.

Take the American Petroleum Institute, take their stand for instance. It is composed of some of the world's largest oil companies. They have much of their reserves and a good deal of production overseas. Their opposition is understandable since our program will reduce oil imports.

I am gratified, however, that some of the members of the API, like Arco and Shell, agree that what we are trying to do for the country is worthwhile. Not only have those firms endorsed our program, but we have also gotten the support of a broad spectrum of the energy business from the smaller, independent oil and gas producers all the way up to electric utilities.

Now let me make a few broad points about the energy tax and then let's get into some of the specifics. First, the program is fair. It is fair economically. It is fair geographically and you can see that from the first chart. The energy tax averages less than 1 percent of consumers' income across the country. This is how it affects the various regions in the States. [A showing of charts.]

So rather than singling out any particular fuel, we went after the BTU content of all of our fuels and energy sources.

Second, we should look at what this tax accomplishes and what it will cost American families. Obviously, it is a vehicle for deficit reduction. But at the same time we are encouraging a shift toward cleaner fuels, reducing pollution, encouraging conservation, and cutting back on our import of oil by an estimated 400,000 barrels a day.

Let me put that number in perspective for you. Over a year's time, that's about the energy equivalent of the amount of gasoline it would take to drive every automobile in the United States 1,000 miles. Conserving energy, reducing pollution, cutting energy imports, and reducing our deficit are significant accomplishments.

You should also remember that as we reduce the deficit we lower interest rates, raise investment, and increase long-run productivity and growth. This tax, contrary to what some might argue, will not be a drag on our ability to compete in world markets. [A showing of charts.]

You can see that on the second chart, that we estimate that on average manufacturing production costs will rise just one-tenth of 1 percent because of this tax. That is exemplified. It is portrayed on that chart.

It will be more costly in a few industries, such as those which are very energy intensive. But if we would have exempted them, it would have required higher taxes on other energy users and it would have undermined our objectives, increasing energy sufficiency, efficiency, and increasing energy security.

The deficit reduction impact of the energy tax should reduce interest rates and thus capital costs. That is beneficial for energy intensive industries, which also tend to be capital intensive.

I think there was a direct correlation insofar as what has happened to interest rates and the fact that this administration was seriously considering an energy tax. In fact, the day that it was floated as an option, on a Sunday, on a national TV show, on Monday the bond market reacted substantially in reducing interest rates.

The CHAIRMAN. I believe that was Meet the Press and you were the floater. [Laughter.]

Secretary BENTSEN. Modesty prevented me from using the name, Mr. Chairman. But thank you.

Other elements of our package, such as the investment tax credit and the AMT relief should benefit those industries. [A showing of charts.]

The next chart shows that even after our tax is fully in place our energy costs will still be the lowest among our G-7 partners, or second lowest depending on what fuel you considered. Canada would be the other one.

And energy costs in Europe could go up even more if this new carbon and BTU tax they are talking about is put into affect. The Japanese are also considering a new energy tax, although their energy costs already are among the highest in the world.

What will our proposal cost Americans? In general terms, it is well under the 1 percent of disposable personal income.

We calculate that when fully phased in the direct cost of the tax on electricity, natural gas, home heating oil and gasoline for a typical family of four with an income of \$40,000 will be just \$9.50 per month. That is the direct cost.

Our entire revenue program, including the energy tax, adds up to just \$17 a month for the average family at the \$40,000 level 4 years from now. A family who is refinancing a \$100,000 mortgage at 10 percent reduced to 7 percent is already saving more than \$200 a month. Several times the energy tax.

You have to remember that one of the goals of our deficit reduction program is to keep those interest rates down and reduce interest costs for consumers, for business and for government.

When we designed this tax, we paid very close attention to its impact on all Americans. A four-person family with earnings of \$25,000 a year is roughly \$40 a month better off when the expansion of the earned income tax credit is taken into account. And for families that do not qualify for the EITC, we have also expanded the Low Income Home Energy Assistance Program (LIHEAP) and food stamps.

Now let me get into a few of the more specific details and then I will try to answer your questions.

The choice of the energy tax. Before we settled on a BTU tax, we considered a number of energy tax options in looking for the right combination of environmental and energy security benefits, regional neutrality and balanced impact on market shares of our various energy sources.

We rejected taxes that were aimed at specific fuels, such as gasoline or oil imports because they would have a disproportionate impact on some regions of the country. The impact would be particularly severe in the case of an oil import fee, which would cause energy costs to increase by much more than the tax.

If we taxed the carbon content of fuel, even though not specifically aimed at coal, it would have had a disproportionate impact on coal and on the regions that produce and use coal.

We also considered an ad valorem tax on energy. Frankly, that's the first one I looked at. But we rejected this approach because it

would amplify the affects of sudden changes in energy prices and it would not present a predictable stream of revenue.

The proposed BTU tax, unlike taxes aimed at a specific fuel, applies to the heat content of all major energy sources. Thus, no region gains or loses because of its dependence on a particular energy source or because it is an energy-producing region or state.

In addition, a BTU tax is a stable revenue source that is not directly tied to changes and energy prices. This is not a pure BTU tax with all its sources taxed at the same rate. Instead, the tax is generally imposed at a basic rate of 25.7 cents per million BTUs. There's a supplemental rate of 34.2 cents per million BTUs for oil.

Without the extra tax on oil, the tax on natural gas would be higher as a percentage of price than the tax on petroleum products. Yet it will not hurt the sale of our domestic oil production since every barrel will be sold and the price will not be decreased.

We also were concerned that not adding the supplemental rate would discourage natural gas use and frustrate the environmental and energy security objectives of the tax. That is an important issue here. We are quite serious about the goal of protecting the environment.

Natural gas is a clean burning fuel and abundant supplies are available domestically. On the other hand, oil use, particularly as a motor fuel, contributes to air pollution.

Additionally, as imports rise, so does the risk of environmental damage from spills and the concern about energy security rises, more dependence, too often on politically unstable areas around the world. All we have to do is think about the embargoes of 1973 and 1974 and understand the vulnerabilities of this country. Where today almost 50 percent of our oil is now being imported and a very major part of our trade deficit comes from that dependence on foreign oil.

Last year we spent about \$43 billion on imported oil. That is more than half of our \$84 billion merchandise trade deficit. We get about 40 percent of our oil from overseas. And if we get too dependent on imported oil, we are vulnerable to that embargo.

Now let's discuss the basic design of that BTU tax. In providing a detailed description of the administration's proposed BTU tax with my testimony, I would like to summarize the principal features.

As you know, when we announced our preliminary decision on the broad concepts of a BTU tax, we also invited comments from those most affected by that tax. And particularly we wanted to hear from the energy industry, industrial end users, state and Federal regulators, and the Congressional offices. And we sure heard from you.

As a direct result of these comments, we included comments from many of you. We have significantly refined the initial proposal. The tax is imposed on coal, refined petroleum products, natural gas, nuclear generated electricity and hydro electricity. Imported fuels and electricity are taxed in the same manner as their domestic equivalents.

The basic tax rate of 25.7 cents per million BTUs applies to all taxable energy sources. Refined petroleum products are subject to

both the basic rate and the supplemental rate of 34.2 cents per million BTUs.

However, the supplemental rate does not apply to liquefied petroleum gases regardless of whether they are produced from natural gas or from crude oil. And it does not apply to natural gasoline and home heating oil.

We decided to collect the tax at the point that it satisfies three criteria. Minimize the number of taxpayers or tax collectors. It is far enough downstream to ensure that fixed price contracts do not prevent a pass through of the tax to the end user. It is also far enough downstream to be certain that domestic and imported products are taxed at the same rate.

Most of the collection points for the tax have been modified or clarified since our original proposal generally, as a result of applying these criteria to new information we got, some of it from Committee members.

For example, Senator Breaux and Senator Boren and others expressed concern over the possibility that the tax on natural gas might be collected at the well head. We agreed it would be a problem because it involved large numbers of taxpayers. Many of them would be unable to pass through the tax because of fixed priced contracts.

We opted to generally impose the tax at the city gate and we decided the tax on oil should be collected at the refinery tailgate. That equalizes the tax applied to imported and domestic refined products.

In the coal industry we found that if we put the collection point at the mine mouth it would have caused three problems. Small mines would be burdened with measuring the BTU content. In some cases it would cause a doubling up on royalties and state severance taxes. And it could prevent a pass through for fixed price contracts.

It makes more sense to put the collection point at the utility or at the industrial end user. It should solve all of these three problems and be far easier to administer.

A number of utilities, there was a similar pass through problem for independent power producers if they are operating with fixed price contracts. We agreed and we have addressed that concern with a special provision dealing with the power produced under existing fixed price contracts.

Now on the application of the tax. We are not imposing the tax on non-fuel products, non-fuel uses of fossil fuels or on exports. Non-fuel products include such things as asphalt, lubricants, waxes. Non-fuel uses of fossil fuel include using it as a feed stock.

The exemption for export applies to both fuels and electricity. In the case of exported electricity generated from fossil fuel, appropriate credit will be provided. Jet fuel and bunker fuel used in international transportation will be exempt so there is no competitive problems in this industry.

You know, sometimes, Mr. Chairman, we get criticized for some of these changes. But this is in reply to members of this Committee who have had constituents talk to them about specific concerns. I must tell you that there are many others that we did not respond

to because we did not think there was equity in the process of doing so.

The last time I was here a number of you raised some issues about the application of the tax and we have addressed many of those with, hopefully, clarifications. For example, Senator Conrad alerted us to the potential for a double tax on the coal gasification facility which makes synthetic, natural gas from lignite coal.

In effect, we would have been taxing the coal that went into the synthetic natural gas production and then turning right around and taxing the synthetic natural gas. He was right. And we did not intend that to happen. We are just going to tax the synthetic natural gas.

We have got something similar in the pump storage for generating electricity. You know how that works in off peak times use and power. Then you pump the water back up hill and then you run it down through the turbines at peak times to get the extra electricity.

Under our original proposal, both the power used to pump the water and the hydroelectricity would have been taxed. Now we are going to tax that power only once.

Senator Wallop told us it takes steam to get heavy oil out of the ground. To meet environmental regulations you often have to buy natural gas from off the site to produce the steam. We would have been taxing that gas, but not taxing heavy oil from the site used for the same purpose.

We decided that wasn't fair and we didn't want to hurt heavy oil production. We fixed that problem. The natural gas is exempted.

We also learned that the energy industry had a similar problem in cases where they use energy to extract or process fuels. We have exempted crude oil or natural gas that is used where it is extracted to get out more crude oil or natural gas; and we will not tax crude oil used in a refinery or natural gas used in a natural gas processing refractionation plant.

Senators Daschle, Conrad and others had concerns about the application of the tax to ethanol and methanol. When we looked into it, we concluded that oxygenates such as ethanol, methanol, ETBE, and MTBE, and the feed stocks used to produce them would not be taxed.

This decision is consistent with our objectives of encouraging using alternative fuels, reducing our dependence on foreign oil, cutting down on pollution.

One of the things we were very concerned about was making certain our proposal had regional balance. Initially we looked at applying the supplemental oil rate to home heating oil.

Chairman Moynihan, Senator Mitchell, and others on this committee, reminded us that in many areas natural gas is just not available for home heating. Homes in those areas are dependent on home heating oil, propane or butane. By treating home heating oil as we treat other home heating fuels, like natural gas and propane, we maintain the balance across our regions.

There also were concerns in the northwest about the partial application of the oil supplemental rate in the formula for taxing hydroelectricity. We responded to those concerns. But we believe hydroelectricity should be subject to the tax itself.

Although hydroelectricity is arguably a renewable source, the energy tax is a deficit reduction measure and exempting hydroelectric power entirely would cost substantial revenue and taxing it is necessary for regional balance. We cannot ask other regions to pay a tax on home energy cost, but exempt regions where those costs are now the lowest.

Lastly, environmental concerns led us to exempt coal seam methane from mines being degassed prior to operation. We did that because it encourages capturing that greenhouse gas rather than venting it into the atmosphere. [A showing of charts.]

Now as you can see on my last chart, the energy tax offers us a significant opportunity to make a major contribution through our deficit reduction plan while simultaneously cutting pollution, encouraging energy conservation and reducing our dependence on imported fuel.

And as we lower that deficit, we get lower interest rates, more investment, and more productivity. When we do all of that, we improve wages and our long-term standard of living.

Mr. Chairman, as we were saying earlier, raising taxes is never easy. It is not a popular process. I know that the votes that lie ahead for this Committee will be tough ones. But I have sensed a new realism in the Congress and amongst the American people. I think everyone now knows that we have to change the status quo if we are to change our Nation's economic course.

This tax offers the way to do that. I look forward to working with you with this and all the other programs. Thank you very much.

[The prepared statement of Secretary Bentsen appears in the appendix.]

The CHAIRMAN. Thank you, Mr. Secretary. That was a masterful exposition of a challenging subject. I would like to congratulate you and Secretary-designate Samuels in having put it together with such sensitivity. I cannot doubt there will be other adjustments that will occur to you, or some member of this Committee, or the House.

But just to follow the specifics in order to get a grasp of the American economy from a rare perspective—where energy comes from and where it goes and what it does—it certainly was an education to this Senator.

Senator Packwood has not yet had a chance to speak on the subject of this tax.

Senator PACKWOOD. I will wait and ask questions.

The CHAIRMAN. Would you like to ask questions?

Senator PACKWOOD. I will ask a particular one. I take it the sole reason for treating hydro differently from a BTU standpoint is simply that if you did not treat it differently the cost of hydro would be significantly lower and that would be unfair regionally.

Secretary BENTSEN. Regionally the imbalance is the primary problem.

Senator PACKWOOD. Because you cannot use the argument for environment on the hydro.

Secretary BENTSEN. Well, some do, frankly. I do not join in that, Senator.

The CHAIRMAN. You do not have much hydro in Texas.

Secretary BENTSEN. We have a bit. I can remember a Congressman way back in 1948 that helped put in a project.

Senator PACKWOOD. And the reason for treating coal differently is that if you were to treat it on an equal basis you would very disproportionately and adversely affect some of the coal in the Appalachian.

Secretary BENTSEN. Senator, that is right. They feel that in the Clean Air Act that they took quite a hit at that time.

Senator PACKWOOD. The next question, this is the effect of the tax, Mr. Secretary. If the CBO studies are accurate, 70 percent of this does fall on people who make \$75,000 or less. Do those equate with the Treasury figure?

Secretary BENTSEN. I do not have that exact number. I do not have that exact figure.

Senator PACKWOOD. I think they are conferring now.

The CHAIRMAN. You can send it in.

Secretary BENTSEN. I am going to have to. They are giving me a number I do not quite interpret right. They are telling me that our numbers are consistent generally with CBO, but I'm not sure how that relates to you, Frankly.

Senator PACKWOOD. Well, I was taking mine from CBO. But I realize on occasion there is a difference of definition as to what income is.

Secretary BENTSEN. I am told then that ours are generally consistent with CBO.

Senator PACKWOOD. The third question. There are stories of deals and rumors of deals and industry being bought off and what not. Has any concession been made to the airline industry? Are they going to get some kind of other tax relief? Their argument being made they are hit very hard on this because they are, obviously, using lots of fuel.

Secretary BENTSEN. They are getting this specific relief. That is on the international flights. That would be exempt from the tax.

The CHAIRMAN. Isn't that what you said, sir?

Secretary BENTSEN. Yes, I guess I did.

Senator PACKWOOD. But no rebate on the airline ticket tax?

Secretary BENTSEN. No.

Senator PACKWOOD. Or no other kind of tax treatment?

Secretary BENTSEN. No.

Senator PACKWOOD. No other kind of deals that you know of?

Secretary BENTSEN. No.

Senator PACKWOOD. Thank you.

The CHAIRMAN. Thank you, sir.

Senator BAUCUS?

Senator BAUCUS. Thank you, Mr. Chairman.

Mr. Secretary, earlier this year I raised the question about the aluminum industry. I am just curious of why there is no adjustment there because obviously the electricity used in making aluminum is a feedstock.

Secretary BENTSEN. Well, they argue whether it is a feed stock.

Senator BAUCUS. And second, there is no way in the world they can pass on the cost increases. London metal exchange prices have held at about 51 cents a pound for a long time; and Russia is

dumping aluminum on the market in the foreign exchange. I am just curious as to what was done here.

Secretary BENTSEN. Let me give you a prepared answer and then I will speak to one.

Senator BAUCUS. Would you please.

Secretary BENTSEN. Should electricity be used in the production of aluminum? When it is used should it be classified as a feed stock? Which you are stating that point of view.

In making petro-chemicals the atoms of the feed stock hydrocarbons become the atoms of the polymers and other products. This is the meaning of feed stock in the administration's proposal.

Aluminum smelting uses direct current electricity to split aluminum oxide into aluminum metal and oxygen. A molten aluminum collects at the bottom of the cell where it is drawn off periodically. Contrary to claims advanced by some industry sources, electricity does not contribute net electrons to the reaction that contributes the energy that causes the chemical reaction to occur.

Now if you followed that.

Senator BAUCUS. I see. [Laughter.]

Secretary BENTSEN. Let me say to you, Senator, it does give me concern. It is energy intensive. As much as 3 and 4 percent added to the cost of the product. We have not found a way to resolve that yet. But I am sure that this Committee and the House Committee will be further addressing that concern.

Senator BAUCUS. I appreciate that. On coal, the administration suggests that the supplemental tax on oil is necessary in order to better assure that the price of natural gas would be favored as opposed to petroleum products. Was the same rationale used in considering the impact of the BTU tax on western coal. It hits western coal three times harder than it affects eastern coal. That is basically because the price of western coal is much lower in the market than the price of eastern coal.

To add to that, the transportation costs of western coal, which are much greater than the transportation costs of eastern coal, and you said earlier that some of the Appalachian producers felt that they were dealt with unfairly in the Clean Air Act. That is the first I have heard of that.

I managed the Clean Air Act on the Floor of the Senate. Basically, all these regional imbalances were worked out when we passed the Clean Air Act in the Senate. I am quite concerned that the affect of the BTU tax will hit western coal producers three times greater than eastern coal producers.

I was curious whether the administration is aware of that and if so how the administration might respond to it.

Secretary BENTSEN. Senator, I get some quite different numbers. I show on sub-bituminous coal that the percent of the price is 19.4 percent; and on bituminous coal it is 16.8 percent. It is not really a very big difference.

The CHAIRMAN. Could you help us with sub-bituminous? Is that western?

Secretary BENTSEN. Well, the sub-bituminous is the western coal as I understand it. Bituminous is the eastern coal.

Senator BAUCUS. Well, the figures I have—and everybody has his own figures—is that in Wyoming and Montana the percent increase

due to the tax will be 70 percent to 90 percent versus eastern coal with 29 percent. I was just handed these figures. I don't know the source of them.

Secretary BENTSEN. Well, let me state——

Senator BAUCUS. It is a very deep concern of western products.

Secretary BENTSEN. Let me say that this is the price differential, percentage wise, as far as coal delivered to the utilities. Now I am not sure at what point your numbers come from.

Senator BAUCUS. Well, if it is coal delivered utilities it is even more disproportionate because of transportation costs.

Secretary BENTSEN. Anyway, let's see if we can get our numbers together. These are projections that—the question they have brought up is that your numbers might not be adjusted for the BTU content of the coal.

Senator BAUCUS. It is my understanding that you are using downstream numbers. That is the Joint Committee's advice to me right now. Whereas, these are upstream numbers. Let's see if we can modify a data collection point.

Secretary BENTSEN. Well, we would be happy to get into it and see if we can reconcile these numbers.

Senator BAUCUS. Thank you. I see I have about ten seconds here——

Secretary BENTSEN. I must——

Senator BAUCUS. Go ahead.

Secretary BENTSEN [continuing]. Say that the Department of Energy projects a negligible amount of switching between eastern and western coal due to the tax and that western coal production had been projected to go rapidly over the next 20 years.

Senator BAUCUS. That might be the Department's projection. I can just tell you having talked to producers at home, that is not their assessment of the situation. Thank you.

The CHAIRMAN. Mr. Secretary, Senator Baucus has raised what I think will be a very typical and repeated inquiry about specific sectors and specific fuel. I think it would be helpful if we could arrange with you through Mr. Samuels a process of inquiry as to how to sort out our numbers here.

I think, for example, there is a much lower BTU content in western coal than eastern coal and so forth. It would be helpful to have some system where we will get answers and might reach agreement.

Secretary BENTSEN. We would be happy to do that, Mr. Chairman.

The CHAIRMAN. We will share them with everybody. They just need to be bilateral.

Secretary BENTSEN. I must say we went to great lengths to try to get regional balance. You will never get it exactly right. And some instances on a per capita basis, where one region comes off better, it may to a lesser extent not for income basis per capita.

The CHAIRMAN. But your point is that, if we do not deal with this deficit we are all in trouble.

Secretary BENTSEN. We are all in trouble. That is right.

The CHAIRMAN. Senator Bradley?

Senator BRADLEY. Thank you very much, Mr. Chairman.

Mr. Secretary, I was intrigued by testimony and the concerns that you took into consideration of various members. Could I ask you, is this the final list of exemptions? [Laughter.]

Secretary BENTSEN. Well, I have a hunch that the Committee will work its will and we may find some changes to the legislation in the process.

The CHAIRMAN. Is there a motion that we declare exemptions closed?

Senator BRADLEY. I so move.

Did you get support for the BTU tax with these exemptions?

Secretary BENTSEN. I beg your pardon?

Senator BRADLEY. Did you get support for the BTU tax with these exemptions?

Secretary BENTSEN. Well, obviously so. We are responding to a number of the concerns of members and in these instances we thought they were equitable and some unintentional things were happening that we had not anticipated. Senator Conrad is a good example of it. We were double taxing that facility. That was wrong.

Senator BRADLEY. Let me ask you specifically about the exemption for coal seam methane from operating mines. If you are already receiving Section 29 credit, will you still fall under the exemption?

Secretary BENTSEN. Most coal bed methane that is qualified under Section 29 of the Tax Code will not qualify for the exemption.

Senator BRADLEY. Will not?

Secretary BENTSEN. Will not.

Senator BRADLEY. Thank you very much.

The CHAIRMAN. Thank you.

Senator Roth, you have not had a chance to speak this morning.

Senator ROTH. Thank you, Mr. Chairman. It is always a pleasure to welcome our distinguished Secretary.

Mr. Secretary, a group of us wrote you asking you to provide tax burden tables according to adjusted gross income. The administration's tax distribution tables are based on family economic income—or FEI. I am not objecting to that. I understand that that has been done before.

The problem is the average American does not know what family economic income is, but has a pretty good idea about what AGI or adjusted gross income is because they have to put it on the top of their own tax return.

Given the fact that the administration already publishes hundreds of thousands of tax statistics, classified in terms of AGI, why not provide the American people and the Congress with data on the impact of the Clinton plan displayed by income group, defined by AGI?

Now in answer to my letter it was pointed out that the administration felt FEI was a better measure of income. But as I said, the average person understands AGI and it seems to me that is information that should be available.

Secretary BENTSEN. Well, I would say, Senator, that the family economic income approach was used under the Ford administration, was used under the Reagan administration.

Senator ROTH. Mr. Secretary, I am not quarreling with the fact that others have used it. I am just saying that whatever information is most meaningful to the public ought to be available. I do not understand the reluctance of the administration to provide this information.

Secretary BENTSEN. Well, we think, frankly, that it is a broader and a fairer presentation of family income and we also have, of course, a situation where Congress' Joint Tax Committee, it does not use the AGI for that purpose either. We think it is more representative. That is why, Senator.

Senator ROTH. Well, as I said, we are not arguing with you supplying it on that basis. But I am arguing the fact that the public better understands AGI.

Let me go on. I would like to know more about your estimates of the number of jobs that will be lost as a result of this new energy tax. Now according to some figures this tax will actually raise roughly \$33 billion a year if you simply multiply the energy used by the tax rate.

Now the Treasury estimates the amount is closer to \$22 billion. Can you tell me what is it that causes a loss of this \$11 billion? Then, in addition, as I understand your proposals, you would offset part of the effect of energy tax by increasing food stamps, LIHEAP, and the earned income tax credit, all of which total about \$11 billion.

So as I calculate it, you are raising \$33 billion a year in taxes and losing or spending at least two-thirds of that tax. It seems to me that is not a very rewarding measure. What figures does the administration have as to the impact on jobs that will be lost as a result of this?

Secretary BENTSEN. I think what you have to do, Senator, is look at the overall package of what the administration is proposing. You are looking at something that has already had a material reduction on interest rates and that provides additional capital at lower costs which should lead to home building, in addition to the investment tax credits. It should lead to further modernization and the creation of jobs and increased competitiveness of this country in the international markets.

You would have to look at that whole package, not just the one.

Senator ROTH. Well, just let me point out that DRI McGraw-Hill, which is a very respectable organization, predicts that it will cause a loss of something like 400,000. Nomura Securities predicts a loss of 400,000 jobs. The National Association of Manufacturers projects that the plan would actually reduce job creation by 1.2 million over 6 years.

Would you agree that the energy tax in itself is going to have a negative impact on job creation?

Secretary BENTSEN. I would say that the energy tax with its impact overall on deficit reduction gives us, putting that all together, would end up creating jobs and making us more internationally competitive.

Senator ROTH. Could I just ask a following-up question?

The CHAIRMAN. Surely.

Senator ROTH. I think international competitiveness is of critical importance. And yet, it is my understanding, that this energy tax

will particularly hit hard manufacturing industries, particularly those that use energy. What would be the average effect—

The CHAIRMAN. Can I ask you, what are the manufacturing industries that do not use energy?

Senator ROTH. Well, I do not know of any. But some use it in greater measure as the Secretary pointed out.

The CHAIRMAN. Energy intensive, I guess.

Senator ROTH. What would be the average energy tax on an American auto sale? Do you have any estimate?

Secretary BENTSEN. Oh, I do not have that specific one.

The CHAIRMAN. Well, again, perhaps we can—

Secretary BENTSEN. We can get it for you and be happy to send it to you.

The CHAIRMAN [continuing]. Work out that routine.

Secretary BENTSEN. I don't have it on specific items of production, such as an automobile or a tractor.

Senator ROTH. I think that would be helpful, Mr. Secretary, because cars are a critical manufacturer.

The CHAIRMAN. Well, the Secretary has made the point that apart only from Canada we have the lowest energy cost in the industrial world. Thank you, Senator Roth.

Senator ROTH. Thank you. I appreciate it.

The CHAIRMAN. Senator Conrad, you have been busily taking notes down there.

Senator CONRAD. Thank you, Mr. Chairman; and thank you, Mr. Secretary. I wonder if we could get the very first chart that was put up about regional differences. [A showing of a chart.]

As I read this chart, the impact around the country is roughly six-tenths of 1 percent. So less than 1 percent; about a half of 1 percent and roughly equivalent around the country. I think a very good job has been done of balancing the energy tax regionally.

Maybe we could go to that next chart. Because what I want to indicate is that while a pretty good job has been done of balancing it regionally, there may be other unintended consequences here with respect to individual sectors of the economy. [A showing of a chart.]

This chart shows the impact of proposed energy tax on a typical North Dakota wheat farm calculated by North Dakota State University. Roughly \$1 an acre is the impact. The average size farm in North Dakota is about 1,200 acres.

If we could go to the next chart and get to the bottom line. [A showing of a chart.]

This shows the effect of the BTU tax on farm income. The average farm size in North Dakota is 1,200 acres. The average income is about \$17,000, just over \$17,600. And at \$1 an acre the BTU tax will be \$1,200 for an effect on income of 6.7 percent, which is 10 times—10 times—the effect on income of the average regional impact around the country.

My point, Mr. Chairman and Mr. Secretary, is that agriculture is really taking a disproportionate hit. Let me just say that when one puts together the impact of the budget cuts, agriculture is tied for the highest percentage cut. Then you put on top of that the cuts to the rural electric program which disproportionately affects rural America. And then you couple that with the BTU tax impact.

Agriculture takes a very heavy hit. Traditionally we have exempted from the diesel fuel tax, and also from the gasoline tax in a different way. Diesel fuel is not taxed in a way in which the farmer experiences the tax because certificates of exemption are provided to those who sell to farmers.

On the gasoline tax, a farmer gets a refund. He has to file for it, but gets a refund. I just want to make the point here that while I think you have done an excellent job of balancing the regional impacts, and while I also want to say to you how very pleased I am we are not talking about a carbon tax here today, that there are still problems that exist with respect to impact by sector.

I hope as we go through this process that we will have a chance to address those issues and perhaps you would want to respond in some way. I just wanted to draw this to your attention at this point. I do not think it is fair to ask for a response immediately. I think people have to have a chance to be exposed to the information before they have an answer to the question. I just wanted to draw it to your attention.

Secretary BENTSEN. Well, I appreciate your doing that. It is not something which we have neglected insofar as our concern. It is one of the reasons we responded when we were talking about ethanol, by some of the concerns that were being expressed by people from farming states.

One of the side benefits, of course, for farmers—farmers are always behind in money. I know. I have been one all my life. My family's business.

But these interest rates, these reductions, are going to be beneficial to those farmers. If I ever saw a group that was interested in cutting deficit financing, farmers are. That is their make-up. So that is where we are headed, for the biggest cut in that deficit in the history of our government. And it takes some political courage to do it.

And in accomplishing it, we will not get rid of all the inequities. We are going to try. We have been working at it and I am sure this Committee will.

Senator CONRAD. I thank the Secretary.

The CHAIRMAN. We thank you, Senator Conrad.

Secretary Bentsen, in this respect we are trying to get some agreed-on numbers here, which you are going to make very important legislation. You mentioned methanol.

One of the issues that comes before us is whether the production of ethanol involves more energy than it creates. I think we really need to have from the administration—well, we know what the Archer Daniel Midland thinks. They told us on every editorial page in America. But we would like to know what you think, sir.

Not now. But if you could get us some agreed-on—

Secretary BENTSEN. Mr. Chairman, I can also tell you what Senator Daschle thinks because I have discussed that issue with him at some length. I am sure that there are varying opinions on that particular issue. But to the degree we can reconcile them, I will be happy to reconcile them.

The CHAIRMAN. Some reconciliation we will call them.

Senator Breaux?

Senator BREAUX. Thank you very much, Mr. Chairman.

Thank you, Mr. Secretary, for coming back to the Committee. I want to commend you and your staff for the long hours and the late nights that you all have been putting in to develop this proposal. I certainly hope that all the arrangements are not yet completed and the door has not been shut as we develop the final product that the full Senate and House will be voting on.

There are a few other areas that need to be looked at I would respectfully suggest. But I think that you made a real effort at trying to take into consideration most of the concerns.

But my first point is, why do not we just all recognize that the consumer is ultimately going to pay this tax and quit fiddling around with where are we going to put the tax. Why not just go ahead and impose the tax after oil leaves the refinery, gas leaves the city gate? We are asking American consumers to pay a tax to reduce the deficit, spend on infrastructure, and other wise investment areas.

I think that there are some that would argue that it looks like we are trying to hide the tax. We are just making it very difficult and probably unfair hiding the tax instead of imposing it when the consumer consumes the product.

Secretary BENTSEN. Well, let's address that one. Let me say that, for example, taxing natural gas when it is received by the local distribution company removes approximately 60 million taxpayers from the system. That should significantly reduce the IRS's collection problems.

The tax must also be imposed upstream, particularly in the case of electricity, to encourage energy efficiency and fuel switching. It will not be done otherwise. Electric utilities and their regulators have no incentive to change current fuel patterns. If instead of taxing fuel used by the utility, the tax on electricity was imposed on the ultimate consumer.

I think the pass through of the tax to the end user will achieve the administration's energy conservation goals. That is what we have sought to do.

Senator BREAUX. I am concerned that some utilities and some suppliers are going to have incredible problems with the local Public Service Commissioners who are not going to bite the bullet and not allow the tax to be passed through. They are going to play games with the whole process.

You know, I think when a tax is going to be a consumer tax, we ought to recognize that fact and let the consumer see it and let them decide if it is costing too much they can use less. That is a point we can debate on.

I just think that we ought to go ahead and make sure that the tax is passed through. It is not politically a nice thing to do, but I do not feel that anybody feels that we are kidding them and they are not going to ultimately pay it. The ultimate consumer is going to pay.

My second concern with all this, Mr. Secretary—and we have had discussions with your staff—is that if this tax decreases consumption, I am afraid it is going to decrease the consumption of the highest priced oil, which obviously is domestic oil. I think it would be very unfortunate for us to decrease the attractiveness of domestic oil and make it more attractive to import oil.

Now I know your figures say it is going to decrease oil imports by 1 percent. But I am really concerned that what we are going to be doing is making it much more difficult, particularly for deep water oil, which is not being produced now because the price is too low. If we increase the cost of energy and oil, I think we wipe out any hope of any deep water production from ever occurring.

I am concerned about making our domestic production even more unattractive vis-a-vis imports.

Secretary BENTSEN. Let me say, Senator, I was concerned about that and I kept asking. I said, can you assure me that we are not penalizing domestic production which we are so dependent on. An industry that has an incredible loss of employment and has really had a very difficult time when we are trying to encourage.

They assured me that that would just not be the case, that every barrel of that domestic oil would be sold, and that the loss in production would be insofar as foreign oil and the curtailment in the dependence on foreign oil, which you and I both share. We wanted to get away from that kind of—

Senator BREAU. Is there any possibility of considering something that could be done to be helpful for a deep water type of production? Is that something that needs to be explored?

Secretary BENTSEN. Senator, I do not think I am prepared to comment about that at this point.

Senator BREAU. What about chemical manufacturing, which is very important in my state and I know in your own state as well? They tell me that the tax is going to greatly make exports more unattractive, less viable, and imports much more attractive.

We saw that happen when we passed the Superfund Tax, that imports dramatically increased and exports dramatically decreased. I have a real concern that the same is going to happen in this case because the margin is so very thin in these products.

Secretary BENTSEN. Let me say you are quite right in that my state that I represented so long here in the Senate is heavy in petro-chemicals, as is your state. I checked that. They tell me insofar, with our exemption for feed stocks, that we will not have a problem in that regard. I have been assured of that time and time again.

The CHAIRMAN. Thank you, Senator Breau.

Mr. Secretary, can I ask a point of importance to this Committee? We have from the Treasury your final proposal in this matter, do we not?

Secretary BENTSEN. Yes.

The CHAIRMAN. Thank you very much. That is very important. Senator Daschle?

Senator DASCHLE. Thank you, Mr. Chairman.

Before I address my question to the Secretary, let me just respond to a point that you just made about ethanol. There have been a number of independent studies done showing that, when compared to the way we produce gasoline from oil, there is a net positive energy balance in the production of ethanol.

I would be happy to share them with you, and with other members of the committee, because I know it is a concern that comes up from time to time.

The CHAIRMAN. The issue was raised. It can be resolved.

Senator DASCHLE. Right.

Mr. Secretary, let me commend you, too, for the manner in which you proposed this tax. I think that you have done it in a way that is frankly essential if you are going to make a proposal of this magnitude.

You have attempted to make it fair by applying it to energy consumption as broadly as possible. You have confronted the problem of regressivity by increasing the earned income tax credit for those people whose incomes fall below \$30,000. You have diminished its effect on small business by advocating the investment tax credit and the extension of health insurance deductions. And finally, you have recognized that struggling new energy alternatives that are environmentally advantageous deserve special attention as they compete in the marketplace.

As you said, no one likes new taxes. But I think if we are serious about reducing the deficit, if we are truthful about the fact that we cannot do it with cuts alone, then you have raised revenue, in my view, in as fair a manner as one can find.

What concerns me is the tremendous amount of misinformation, inaccuracy and misunderstanding that have resulted from this proposal. It is hearings like this that I hope will clarify some of this.

Senator Conrad raised a very serious concern on the part of many people in agriculture. I want to pursue that question a little bit with you. The North Dakota study is one that has been brought to my attention, as well.

They indicate that for a family earning \$17,000 the impact of the BTU tax would be about \$1,200. What I wonder, and I have not been able to get the answer, is whether that is before or after the EITC has been applied. It is my understanding that it is before. Once you apply the earned income tax credit, the \$1,200 is substantially reduced, and this creates a completely different set of circumstances in terms of the impact of the BTU tax on the farmer. Could you comment on that, please?

Secretary BENTSEN. Senator, the EITC for a family of four of \$15,000 of income is \$1,012 a year. The EITC is phased in faster than the BTU tax.

Senator DASCHLE. Well, let me ask you, you say \$1,000.

Secretary BENTSEN. Yes. Let me say in turn, that is not the total. That is an increase that you can direct right toward the BTU tax.

Senator DASCHLE. You said \$1,040?

Secretary BENTSEN. \$1,012.

Senator DASCHLE. \$1,012.

Secretary BENTSEN. That is an increase, a net increase in that.

Senator DASCHLE. Net increase in the EITC?

Secretary BENTSEN. That is correct.

Senator DASCHLE. Okay. So if you took the \$1,200 and subtracted from that the \$1,012 you would get roughly—you are talking about \$188. So, would that not then be the real calculation that a farmer who had a \$17,000 income would look at if he were to try to examine its impact on agriculture?

Secretary BENTSEN. That is right. That is true, without any consideration for any reduction in interest rates on mortgages.

Senator DASCHLE. Could you also describe for me how you arrived at this six-tenths of 1 percent? You mentioned in your testi-

mony, I believe, that it is four-tenths of 1 percent for farmers; six-tenths of 1 percent overall in that geographic area.

Could you elaborate a little bit more on how that calculation was derived?

Secretary BENTSEN. As far as regional balance?

Senator DASCHLE. Well, no, just in terms of how it was calculated 1 percent in overall—

Secretary BENTSEN. They took the direct energy costs. Then they took total energy costs, indirect, too, as to what costs would be in that regard and applied it on a per capita basis, and that is related to an income basis of the individual. Those were the final numbers they gave me. I cannot give you the actual actuarial computations.

Senator DASCHLE. I think for the record, Mr. Secretary, it would be very helpful if you could supply that.

Secretary BENTSEN. All right.

Senator DASCHLE. Because I think that is going to be a matter of great interest as we go through these deliberations.

Secretary BENTSEN. Good.

Senator DASCHLE. I would personally like to be able to see that because I think that's really the crux of it. If, indeed, that figure is as accurate as I hope it is, then I think that a lot of the misunderstanding about its overall impact is going to have to be reexamined and clarified. And certainly that calculation is key to the clarification.

I have additional questions, Mr. Chairman, but I realize my time is up. I thank you, Mr. Secretary.

Secretary BENTSEN. Surely.

The CHAIRMAN. Thank you, Senator Daschle. Once again we see the use we are going to get out of better formal submissions of the way we calculate numbers and the way we got our numbers.

Senator Hatch?

Senator HATCH. Thank you, Mr. Chairman.

Secretary Bentsen, I am happy to see you again.

Secretary BENTSEN. It is good to be back. Thank you.

OPENING STATEMENT OF HON. ORRIN G. HATCH, A U.S. SENATOR FROM UTAH

Senator HATCH. Let me just say that I agree with both Senators Conrad and Daschle, that it seems to me this energy tax disproportionately affects and hurts farmers and it is much higher than what the estimates given by the administration indicate. The average farm family is going to pay a lot more.

I partially disagree with Senator Breaux in saying that consumers are ultimately going to pay this energy tax. I think that is true to a large degree. But a lot of those farmers are not going to be able to pass those additional costs on. They will not be able to get a higher price for their products in the market place. And if they do, of course, everything else goes up exponentially. So I am really concerned about it.

On the coal, I agree with Senator Baucus that western coal seems to suffer three times the disproportionate effect of eastern coal. Now western coal is high moisture, low sulphur content, high BTU, environmentally sound coal. Eastern coal is low moisture,

high sulphur, less environmentally sound coal. In other words, you need to blend it to do it.

But if we are going to give the benefit to the eastern coal versus the western coal, it seems to me that flies in the face of the administration's environmental concerns. We are very concerned about it out there.

In Utah, for instance, we have two counties that basically produce little besides coal. This is going to be devastating to them and they will not be able to compete.

I would like to just say that when the President announced his deficit reduction plan in February, he told us that the BTU tax on a family of four earning \$40,000 per year would be \$17 per month or \$204 per year. Now, that \$204 per year was represented as an almost harmless, minimal sacrifice that the administration felt people would be glad to pay in the interest of deficit reduction.

However, the latest information that my office has received from Treasury, from the administration, now indicates that the impact for a family of four of the energy tax on my home state of Utah would be at least \$416 per year. I am concerned about that new estimate.

By the Treasury's own admission, the impact of the energy tax on a family in Utah would be more than double what it was estimated just 2 months ago. And just last fall we were led to believe as Americans that the Clinton plan would not raise taxes for anyone but the very wealthy.

But this seems to, again, be a disproportionate burden on those who are not wealthy, but who are less wealthy and certainly in many cases almost poor. All of the administration's statements concerning an energy tax had stressed the supposedly small impact of such attacks on direct household and business spending on energy.

Now, in fact, the latest Treasury estimates, as shown by the chart that was up there a few minutes ago, show that Utahans would only pay an extra .63 percent or about half of 1 percent of their disposable income on higher energy taxes.

Estimates from my state indicate the direct costs of the tax, once it is fully implemented, could be approximately \$190 million in resources being transferred from Utah consumers and businesses to the Federal Government.

Do you have any additional information that details the direct cost to households and businesses from this modified BTU tax?

Secretary BENTSEN. Let me say, Senator, in just talking to staff, we do not have any numbers that follow the numbers that you have given me. I am not sure where those numbers come from.

Senator HATCH. Well, I have a sheet here that is called, "Description of Modified BTU Tax," which I believe was put out by Treasury. These numbers show that the impact on consumers of energy tax by region that a lot of states would be .63 and \$104 per capita tax increase right here. That comes right from your office.

Secretary BENTSEN. But you just gave me a number far beyond that one.

Senator HATCH. Really, that is a family of four, \$416.

Secretary BENTSEN. Is that what you just said?

Senator HATCH. Oh, yes, I was talking about a family of four which is what the President said. It would be about \$204, 2 months

ago for a family of four. Now it is up to \$416 and that is just the direct costs.

Secretary BENTSEN. Senator, we do not know where that number comes from.

Senator HATCH. Well, it comes right out of your own—maybe I have somebody else's document, but I think this is from Treasury. It is entitled, the "Description of Modified BTU Tax." Maybe I am reading it wrong, but I do not see how I can read it wrong.

Secretary BENTSEN. You are multiplying the per capital times four, is that what you are doing?

Senator HATCH. By four. A family of four. It says per capita. It does not say per family. So \$104 times four is \$416 per family.

Secretary BENTSEN. Your problem is that a family's consumption of energy does not rise by four, not at all.

Senator HATCH. Well, then why do they use an amount per capita then?

Secretary BENTSEN. Well—

Senator HATCH. I am not trying to give you a rough time. I just want to point that out. [Laughter.]

You are the last guy on earth I would try to give a rough time to, I tell you.

Secretary BENTSEN. It seems to me it is incomplete. Let us take a look at that.

Senator HATCH. I have a lot of other questions that I think could be considered giving a rough time to the Secretary.

Secretary BENTSEN. Your problem, Senator, one person—four people do not necessarily, obviously, use four times, living together, do not necessarily use four times as much energy.

Senator HATCH. Okay. Maybe they ought to use a different definition than per capita.

Secretary BENTSEN. Perhaps.

Senator HATCH. I think it might be a little bit better.

Secretary BENTSEN. Okay.

Senator HATCH. But that is the way I read that.

Excuse me, Mr. Chairman, if I could take just one more minute.

The CHAIRMAN. Senator Hatch, I just want to get order so you can be heard.

Senator HATCH. Yes, just one sentence. I appreciate that.

My belief is that when you add in the indirect costs and the exponential add-ons that every business is going to add on to the ultimate consumer, it is going to be much higher than that. I do not think there is any question about it. But again I am not trying to—

Secretary BENTSEN. Well, I must say they took behavior response into consideration, obviously, in trying to come down with these numbers.

Senator HATCH. Well, I think your numbers are pretty low. They have got to be low, Mr. Secretary. They have to be. And whoever is doing them is taking the absolute lowest scenario.

Secretary BENTSEN. Well, they took behavior response and they tried to take all direct and all indirect costs in coming up with that number.

The CHAIRMAN. Can I just—

Secretary BENTSEN. Let me say, in no way did we try to influence the number. We were asking for reality. That is what we have been able to receive, we hope.

The CHAIRMAN. Mr. Secretary, may I say that I do not think we have Senator Hatch's vote yet. But when this table is emerging, no doubt, will he see things in another point of view. Then again, there is going to be more data coming. Thank you, Senator Hatch. Senator Boren?

**OPENING STATEMENT OF HON. DAVID L. BOREN, A U.S.
SENATOR FROM OKLAHOMA**

Senator BOREN. Thank you very much, Mr. Chairman. I want to associate myself with the remarks about agriculture made earlier by Senator Conrad, who I think expressed the situation very well.

I want to turn to another matter briefly, Mr. Secretary. That is to the problem of lifting cost to oil and gas production. I want to say first of all, of course no one knows more than you about the economics of the oil and gas industry. I appreciate the fact that the administration has already been sensitive to this problem and the depressed state of the industry as it has considered the collection point question with the BTU tax.

I just received the information this year from the Oklahoma Geological Survey in the last few days, which indicates that in 1993 my state, for example, will produce less than 100 million barrels of crude oil. That is the first time that that has happened since 1919. So, virtually since the discovery of oil and the production in commercial quantities, this will be the lowest year on record.

That trend is mirrored around the country, as you well know. The rig count is still hovering around 600 which is a historic low for the industry. One of the things that concerns me especially is the fact that the BTU tax will have a potentially very harmful effect on our stripper and marginal production.

In our state, for example, 73,000 of our wells, about three-fourths of them, are classified as stripper wells, producing very little oil at very high cost. Some of our wells are even producing 100 barrels of salt water for every barrel of oil.

This, of course, causes a huge pumping cost. Most of this pumping is done by electric motor as you know, Mr. Secretary. I commend the administration for containing an exemption in your BTU proposal for natural gas use for enhanced oil recovery of heavy oil. I think this makes a great deal of sense.

But I am very concerned that we are going to have the premature plugging of some of these marginal and stripper wells where the cost of electricity for pumping that oil is so high we are already right at the margin. They are barely breaking even. We lost 2,000 of those well in Oklahoma in the last 2 years that were plugged because the lifting costs, primarily electric, finally exceeded the value that you could get from the well.

I am wondering if any consideration could be given to one of two things. Either expanding the exemption to include the cost of energy use for lifting oil or enhanced recovery of fossil fuel as well as the use of natural gas or enhanced recovery. Or perhaps some kind of a credit for marginal or stripper wells it would help offset

the increased cost of electricity on these marginal and stripper wells.

I realize this may be the first time this issue has been raised. I do not expect you to give me a definitive yes or no at this point. But I wanted to raise the problem and put it on the radar screen at Treasury and express the hope that at least there might be some consideration given to this particular cost as it is involved in energy production and these very fragile, very marginal wells that otherwise might be plugged.

Secretary BENTSEN. Senator, you make some very valid points about the problems of the industry and they are a serious concern for all of us. You and I and Senator Wallop, Senator Breaux, Senator Conrad, Senator Baucus, a number of us, worked very hard on that last year. And we made some major headway in that regard and major concession to independent producers to try to assist them in that.

If there is anything further to be done, we have not presented it in the legislation. And as I have told the Chairman, our legislation is complete and we now turn it over for consideration of this Committee and the Ways and Means Committee in the House.

Senator BOREN. Well, Mr. Secretary, I would just hope perhaps at least to have considered the increased cost of electricity on marginal wells, that it might be something we would at least look at or that you might keep an open mind as we look at that in the Committee.

Secretary BENTSEN. Thank you.

Senator BOREN. Thank you.

The CHAIRMAN. Thank you, Senator Boren.

Senator Durenberger?

OPENING STATEMENT OF HON. DAVE DURENBERGER, A U.S. SENATOR FROM MINNESOTA

Senator DURENBERGER. Mr. Chairman, thank you.

Mr. Secretary, I guess, as Winston Churchill once said about Americans, we always end up doing right, but only after we have tried everything else. This committee has always struck me as a wonderful microcosm of America because we represent so many varied interests in this country.

The one difference between this Committee and the average American is we usually get to do the right thing ahead of most other people. I think that has been your experience, but, again, only after we have tried everything else, which is what this hearing seems to be all about.

I would like to reflect a concern that has been consistently expressed today about rural America in rural Minnesota. It is not just the combination with the increased fuel tax on barges and the cutback on the estate taxes and a lot of other things. It is the reality that rural Americans have been living as pricetakers for so long in our society that is very difficult for them to deal with increased costs.

So I would first just add that personal reflection from my part of the country, to what you have heard from others.

A second thought is that this tax has two values, I would say, as a tax. One is that it is broad-based and the other is that it is

based on consumption, and I like both of those. But the temptation in a tax system like that is to create exemptions and we are beginning to hear some of them already. We heard some of them on the floor of the Senate.

I would just express a concern about the known temptation that all of us cannot resist the urge to add exemptions to a broad-based, consumption oriented tax.

A third is an observation learned over the last couple of weeks in particular, that is: We have to ask "a tax for what?" It is just an observation from a friend that says, unless we can get behind us some of the issues that have been created between us, the administration—and not just Republicans, but a lot of the rest of us here—about what it is we are doing with the fiscal process here, it is going to be very, very difficult to sell even a very good tax in my State of Minnesota and I do not classify this as a good tax.

The fourth issue that I might ask you to comment on as others may have is the issue of international competitiveness. We have all of the taconite that goes into American steel, practically. There is a little in northern Michigan and some comes out of Canada. But we have much of the raw material that goes into American steel today.

We have a large proportion, for a relatively small state, of the paper that is produced. Some of the related wood products that are produced in this country as well.

It is that experience that reflects an obvious concern and that is that the one area in which American industry has an advantage over its competitors has been the cost of energy.

And to the degree that government decides to raise the cost of energy, it does so disproportionately across a wide variety of American industry. That will have not only an impact on those industries, of which the two that I have mentioned are highly competitive. Of course we in effect protect, to some degree, with trigger pricing and other mechanisms, American steel. But paper is highly competitive, particularly with northern Europe and some other areas.

So on the margin this tax overcomes the current advantage we have and perhaps could become in some cases a disadvantage. I have read your paper which says its impact, a cross manufacturing in America, is only one-tenth of 1 percent. But in taconite I am told it is around 1 percent, a little bit over; and in paper, it is probably somewhere between five- and seventh-tenths of a percent.

That may seem small, but in industries with marginal profits, it is a fair factor. And in the Congress, which may have a temptation to raise rates, it is a deep concern.

Secretary BENTSEN. Let me say, Senator, on the various points you have raised, the one about farming, for example, that is one of the reasons we did some of the things we did in the way of exemptions that you are talking about on ethanol. We did that one. The other one insofar as what it will do for interest rates, we think it is something that will be quite beneficial to farmers. Most of them owe something on that farm.

And, hopefully, they will be able to do some refinancing that far, far pays many times over for whatever the increased energy costs are.

You mentioned one, I wasn't quite sure what you mean insofar as the estate taxes. There were a lot of rumors that there was going to be a curtailment in the exemption, the \$600,000 exemption, on estate taxes. No such thing has been proposed.

Senator DURENBERGER. Very good.

Secretary BENTSEN. And I have heard no consideration of that one.

Senator DURENBERGER. I am pleased to hear that.

Secretary BENTSEN. I would not have concern about that one.

Now insofar as the international competitiveness and where there are energy-intensive industries, the most that we have been able to find, the most intense, was an increase in the cost of the end product by 3 to 4 percent. That is of some concern.

I would also state though that in comparison to the other G-7 countries that our energy costs, even after the implementation of this tax, full implementation in 1997, it would still be substantially below all of those countries with the possible exception of Canada and that depends on some balance configured one way or the other, that one or the other has the advantage. But overall, we remain extremely competitive.

Senator DURENBERGER. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Durenberger.

Senator Riegle?

OPENING STATEMENT OF HON. DONALD W. RIEGLE, JR., A U.S. SENATOR FROM MICHIGAN

Senator RIEGLE. Thank you, Mr. Chairman.

Let me welcome the Secretary here this morning. I am generally in support of the President's program taken as a whole. There are some concerns about the energy part, mostly about whether it is balanced exactly right.

I might just say that in Michigan we rank among the ten highest energy-consuming states because of the size of our manufacturing base and we are the fourth largest exporting state. So the whole question of how these additional energy taxes come in on the cost of production and work their way through the system is a concern to me.

I want to associate my remarks with those earlier of Senator Conrad in expressing a concern about how this comes in on agriculture. We are a very large agricultural state as well and I am concerned about whether we have a load coming in there in the area of the economy that I think is struggling more and more all the time.

I want to bring to your attention a little mailer that one of our two utility companies in Michigan has sent out now to all of the people that they service in their part of the state.

This is the Consumer's Power Company. On one side they have the names and addresses of all the members of our congressional delegation and, of course, two Senators, and a map as to who is where. Then on the other side they have a summary. The essence of this: it says, "Energy taxes could cost you an additional \$400 a year."

They go on then to state some conclusions. They say the proposed broad-based taxes would raise your energy bills by approximately

\$150 per year depending upon your consumption. Then they have as a second point, that the energy tax would increase the cost of Michigan goods and services you consume by an additional \$250 a year. Then they raise an issue about global competitiveness in terms of us being able to sell as effectively in global markets.

I would appreciate it if somebody who is on top of this in the Treasury Department would take this. I am sure it is typical of what is around in other places in the country. I would like a response to it as to what you would see in reference, a response to the arguments that they make so that I can see how the analysts and react to the assertions made in this particular instance.

Secretary BENTSEN. Senator, we would be happy to do that. I think any time you get a tax, and a major one, there is going to be contentions and you are going to find the interest groups responding to that and trying to sway opinions.

A good example of that is the API and what we are seeing there, the American Petroleum Industry, which has major oil companies, many of them with most of their reserves and production overseas. This will curtail the importation of oil by some 400,000 barrels a day. I am sure that disturbs them.

They have put out some numbers that do not agree with our numbers. I do not know what brings about that difference. We are trying to analyze them now. We will be delighted to look at those numbers.

Senator RIEGLE. Well, I think it would be useful. I would like to have, so that I can put side-by-side—I mean they have taken a look at it and they have drawn one set of conclusions.

Secretary BENTSEN. We would be happy to.

Senator RIEGLE. I would like to see your analysts look at that how you see it on the other side.

Secretary BENTSEN. Fine.

Senator RIEGLE. Also, I have a question regarding how we stack up with our international competitors, particularly our major G-7 competitors around the world. When you look at their energy costs as a cost of production and you look at ours, ours have been lower, have they not?

Secretary BENTSEN. Oh, yes. And even after the implementation of this tax will remain substantially lower with the possible exception of Canada where we are in balance.

Senator RIEGLE. Some have said that the higher energy costs in Europe, in Japan, reflect essentially higher gasoline taxes, which some say is more a tax on consumption and not a broad-based energy tax which would be something like a BTU tax, which would be seen more as a tax on production.

But what is the essential argument as to why a BTU tax is preferable to a gasoline tax?

Secretary BENTSEN. What you run into is different impacts on different regions. Now you take the farming area of your state, and of my state, and there are a number of these states around here, you would use a very disproportionate amount of gasoline as compared to some of the larger cities that have mass transit, that type of thing.

So the impact regionally was quite different and we were trying to get as much regional balance as we could. If you take a look at

the coal tax, the carbon tax, it would be hitting the coal states very hard and they would carry a disproportionate burden in that regard. So we chose not to take that one.

As you look at an import tax on oil, I can imagine what kind of a filibuster we would get out of the northeast on that one and the disproportionate impacts. So those are the things we tried to balance off in taxing sources for the BTU tax, plus hoping to cut back on pollution and further dependence on foreign oil.

Senator RIEGLE. Well, we do not need any more filibusters. We have one too many right now.

Thank you.

The CHAIRMAN. Thank you, Senator Riegle.

May I just respond to the Secretary? It has been an enormously complex task that you have taken on and you have done it very well. I do not have to tell you that we would not settle for a gasoline tax like that. We would take the subways. And you for some reason did not think that was the best approach. That is understandable, too.

Senator WALLOP. No, sir. I hope to not to have to settle for this one either. [Laughter.]

Secretary BENTSEN. You come as a great surprise to me, Senator. I thought you would be very enthusiastic about this.

Senator WALLOP. I thought you might think that.

Mr. Secretary, I have different information, I think, than what you are producing for the Committee as to the energy costs of our G-7 competitors. I think you were talking about gasoline costs.

Secretary BENTSEN. No, sir. I am talking about more than that. Gasoline is very dramatic. We are talking about more.

Senator WALLOP. Well, the Europeans provide massive subsidies for energy and utility fuels. Most European nations, industrial nations, appear to take full advantage of the European community's rule allowing them to subsidize their energy sector by up to 20 percent. You are still saying with that subsidy that they would have higher cost energy than ours?

Secretary BENTSEN. Senator, I am so advised.

Senator WALLOP. Mr. Secretary, I would hope maybe that we could get this information verified because it is completely different information than we have.

Secretary BENTSEN. Fine.

Senator WALLOP. Especially in Britain and France. I think that this is not the case.

Secretary BENTSEN. Well, let me give you an example then that they give me. Here are some of the countries that are involved. Italy levies a special tax on light fuel oil used by industry that is 182 percent of the pre-tax price. France, Germany, Italy and the United Kingdom, all a part of the G-7, all impose special taxes on heavy oil, fuel oil, used by industry that range from 11 percent in the U.K. to over 65 percent in Italy of the pre-tax price.

Senator WALLOP. But then the subsidy comes in up to 20 percent. Is that not correct?

Secretary BENTSEN. I do not have that.

Senator WALLOP. Well, I think that is maybe a worthwhile pursuit. Again, dealing with international competitiveness, I think

people have asked my questions about the costs and you even mentioned something about the costs of production of oil and agriculture.

But it is my understanding, as I understand the GATT rules, that the BTU tax as you have currently formulated it and as it applies to U.S. products, is not border adjustable. Is that correct?

Secretary BENTSEN. That is correct.

Senator WALLOP. Well, why should we not make it border adjustable?

Secretary BENTSEN. Well, if we did that, I am sure that would be a GATT violation. I assume it would be.

Senator WALLOP. It depends on where and at what moment in which you apply it.

Secretary BENTSEN. Well, we would run into problems immediately with GATT and we would certainly have problems with the U.S.-Canada Free Trade Agreement.

Senator WALLOP. Well, some would say that this is pretty close to a direct subsidy on Canadian energy, depending on how you—

Secretary BENTSEN. I would not share that viewpoint.

Senator WALLOP. And there is another figure around that has been presented uncontested to the Energy Committee that this tax, in fact, increases our oil imports by 100,000 barrels a day, not decreases them by 400,000.

Secretary BENTSEN. Senator, that is dramatically different from the numbers I am given.

Senator WALLOP. Well, I think both have come from the administration. Would there be a way for us to reconcile them?

Secretary BENTSEN. I don't think they can be reconciled, those numbers. But I will be happy to look at it.

Senator WALLOP. Is that light off?

The CHAIRMAN. No, sir.

Senator WALLOP. All right, thank you.

I am concerned by the statement in yesterday's New York Times that the administration is considering a major announcement on global climate change policy which could freeze by the year 2000 greenhouse omissions at 1990 levels. If this new policy is announced, won't there be enormous pressure on you to raise the BTU tax to make this commitment?

Secretary BENTSEN. I do not anticipate such and I have not seen the administration's program finalized.

Senator WALLOP. According to the Department of Energy, which has a very optimistic view of this tax, I must say, the BTU tax would cut greenhouse gas emissions by only some 25 million metric tons by the year 2000. And we will be producing nearly 100 million more in 2000 than we were in 1990.

Secretary BENTSEN. Senator, that is not within the jurisdiction of my Department.

Senator WALLOP. Well, one of the problems that we have is that once you introduce new forms of control of public behavior it is easiest to use that form down the road. I mean, if there is anything that we have learned—you have learned and that I have learned—is that new taxes are virtually irrevocable and they are used as the simplest forms of gaining other public behavioral responses.

Secretary BENTSEN. Senator, I have not found the increase in any tax easy.

Senator WALLOP. It is not easy, but it is easier to increase the tax that is on the table than to find yet another one.

Secretary BENTSEN. I have no anticipation of that.

Senator WALLOP. Mr. Chairman, could I ask that the statement I have been inserted in the record?

The CHAIRMAN. Of course.

Senator WALLOP. An opening statement. Thank you.

The CHAIRMAN. Thank you, Senator Wallop.

And now the last of our first round, and perhaps we are going to be sensitive to the Secretary's demands elsewhere. Senator Grassley?

OPENING STATEMENT OF HON. CHARLES E. GRASSLEY, A U.S. SENATOR FROM IOWA

Senator GRASSLEY. Thank you, Mr. Chairman.

Thank you, Mr. Secretary, for spending so much time with us. Let me tell you I appreciate a person who understands agriculture, being in the high position you are in. I think that that was best represented by the fact that you did see the importance of the ethanol issue and the decision you made on that. Thank you very much for that letter.

My questions, too, deal a little bit with agriculture. If I could reiterate what Mr. Conrad has stated so well, that maybe the disproportionate effect that the BTU tax has on agriculture. You probably are aware of some figures from the American Farm Bureau Federation. They stated that the average 400 acre corn and soybean farmer might pay an additional \$1,600 in taxes. That would be \$800 direct and \$800 indirect.

And, of course, I understand the administration's view of lower interest rates and lower interest rates have already helped agriculture to some extent. But I do not believe that lower interest rates are a guarantee like obviously the increase in this tax and its impact on agriculture is.

I say like two or three of my colleagues have said, it is very difficult for a farmer to pass that on. Again, not to throw out a figure that you would necessarily have to justify at this point, but, there is one other figure regarding some disagreement on what household costs might be from the BTU tax.

Our Iowa Department of Natural Resources which has jurisdiction over the energy costs in our state, has estimated that the BTU tax—this would be the Iowa State Government—has estimated that the BTU tax would cost the average family of four, now a family of four and not per capita, over \$300 per year.

So, you know, I do think that even though the ethanol thing is very much appreciated and it will be helpful, if we have a BTU tax I think overall it could be disproportionately harmful to my state.

Now then I want to go on to some things that I think would make it just a little bit more difficult and then ask for your comment. Speaking of exemptions, I was very disappointed that the 525 percent increase in the inland waterway or barge tax remained in the President's budget despite the fact that there was an overwhelming sense of a Senate vote of 88 to 12 against it.

Then I think it was right after that that the President himself or somebody close to him indicated that he would reconsider it and maybe he did reconsider it. I do not want to say he did not reconsider it. But he did then turn around and leave it right in his budget.

This would have an estimated additional cost of 9 cents to 18 cents a bushel for transportation costs of grain. So my first question is, is the administration still going to consider doing away with the barge tax proposal or is it now a firm part of your plan?

Secretary BENTSEN. Senator, it is a part of our plan. Obviously, it will be given consideration by this Committee and by the Ways and Means Committee. What you have seen since 1986, various legislative initiatives to increase non-Federal cost sharing in Army Corps of Engineer projects and operating costs for special projects now entirely financed by user fees, while the Federal Government continues to finance part or all of the capital costs.

So that part of that initiative obviously is going to be subject to consideration.

Senator GRASSLEY. Well, thank you very much. I hope that you will help us do that. I think it is going to be very difficult for us to do it by ourselves because, you know, it is only one part of the equation. If you do something some place, you have to come up with something some place else.

In regard to the tax as it relates to coal, now I know you have made a decision to move it from the point of mining to the utility. But has it been determined at what point the tax will be collected at the utility? Is it going to be paid for before the coal—I suppose the bottom line is, will it show up as a separate item in the consumer's bill or will it be paid for by the utility before the coal in a sense is consumed by the utility?

Secretary BENTSEN. The tax is paid for by the utility. It would not show up as a separate item.

Senator GRASSLEY. Yes. But the point is, as it is coming in, in other words before it is actually burned by the utility or after that point?

Secretary BENTSEN. As it is coming into the utility, before it is burned.

Senator GRASSLEY. Thank you.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Grassley.

The hour of noon has arrived, and an important panel, including the American Petroleum Institute, is up next.

Are there Senators who have distinct 15-second questions for the Secretary?

Senator PACKWOOD. I have two distinct 15-second questions. One, when can we see legislative language?

Secretary BENTSEN. What?

Senator PACKWOOD. Legislative language, when will we see it?

Secretary BENTSEN. We would anticipate it in the next 10 days.

Senator PACKWOOD. Oh, very good. Thank you.

The second question. I understand Senator Roth's difficulty of attempting to explain family economic income to average families. When you tell them it includes the rental value of their house and

the value of their fringe benefits, they look at you and think you should not be here. I understand what it is.

Do I understand the Treasury will not give to us estimates based upon adjusted gross income, even if the members ask for them?

Secretary BENTSEN. Well, let me give consideration to that, Senator. We, frankly, think that it just confuses the process. But let us look at it.

Senator PACKWOOD. Thank you.

The CHAIRMAN. Mr. Secretary, may I join Senator Packwood in saying I think we should see that because we will end up seeing it from some other source anyway.

Secretary BENTSEN. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Roth?

Senator ROTH. A couple of quick questions.

The CHAIRMAN. No, no, very quick.

Senator ROTH. Will utilities be able to itemize the amount of the tax in their monthly bills to consumer taxpayers?

The CHAIRMAN. You only get one of those questions now.

Senator ROTH. The third time does not count.

Secretary BENTSEN. They advise me it would be the utility's decision along with the regulators.

Senator ROTH. I am not following.

Secretary BENTSEN. They advise me it would be the utility's decision along with the regulators.

Senator ROTH. You mean the state regulators?

Secretary BENTSEN. Well, whatever the regulators are handling that utility.

The CHAIRMAN. Very, very succinct.

Senator ROTH. Mr. Chairman, I would just ask that we have permission to submit further.

The CHAIRMAN. Of course. All of that will be done. Somebody is back there taking notes of all the things you agreed to send. We are pleased that we will have legislative language. And if it takes an extra day, that will do.

Mr. Samuels, we welcome you to this conference table. We hope one day to confirm you. [Laughter.]

With very great appreciation, Mr. Secretary, we thank you for coming here.

Secretary BENTSEN. Thank you, Mr. Chairman. I appreciate returning to the Committee.

The CHAIRMAN. I have just had an occasion to talk with Mr. Packwood. Mr. Noble's confirmation hearings will take place Monday if his FBI file arrives before then. We hope to have him confirmed next week so he can take on the present concerns you have about Waco.

Secretary BENTSEN. Thank you very much. [Pause.]

The CHAIRMAN. Now, ladies and gentlemen, our hearing is not concluded.

If I could ask our distinguished panelists to come forward.

We will now hear from a panel consisting of the producers of energy in our country. They are, respectfully, Mr. Victor Beghini, who is the President of Marathan Oil from Houston and who appears on behalf of the American Petroleum Institute. Mr. Beghini, we welcome you, sir.

And Mr. Eugene Ames, who is chairman of the board of the Venus Oil Company of San Antonio and you are representing the independent producers.

Next is Mr. Robert Catell, who is a constituent and friend of mine and is president of Brooklyn Union Gas Company. He appears on behalf of the Natural Gas Council. We welcome you, sir.

Finally, General Richard Lawson, who is president of the National Coal Association here in Washington. General, we come you.

In the order in which our witness list is taken, first of all, Mr. Beghini.

STATEMENT OF VICTOR G. BEGHINI, PRESIDENT, MARATHON OIL COMPANY, HOUSTON, TX, ON BEHALF OF AMERICAN PETROLEUM INSTITUTE

Mr. BEGHINI. Thank you, Mr. Chairman. It is a tough job to follow the eloquence of Secretary Bentsen and appear before this Committee.

The CHAIRMAN. And not nearly as tough as following that energy flow chart.

Mr. BEGHINI. Well, if you spend 36 years with it as I have it becomes slightly simpler.

Mr. Chairman, I am President of Marathon Oil Company and I am testifying on behalf of the American Petroleum Institute. We endorse the President's goals of reducing the deficit, creating jobs, and enhancing long-term economic growth and we applaud his efforts to reduce spending. We are gratified that the Congress chose to make additional cuts.

We do, however, oppose the BTU tax as part of the package. That view is shared by the majority of Americans. A recent NBC/Wall Street Journal poll found that 62 percent opposed the tax, while only 35 percent favored it.

Clearly, many people are concerned about the effects on jobs and income. We believe the BTU tax will distort energy markets, make U.S. products less competitive in world markets and retard job growth in the economy. By taxing production, the tax will most seriously affect the competitiveness of energy intensive U.S. industries such as refining, steel, lumber, aluminum, airlines and agriculture.

The tax will create highly inequitable results across income groups and across regions of this country. It places the greatest burden on middle-income Americans who spend a greater proportion of their income on energy than do higher income people.

The tax will cripple the domestic refining industry, reduce domestic energy production and narrow the field of competition in the industry by driving small- to medium-size firms out of business.

Rather than enhancing the prospects that the President's overall program will encourage U.S. economic growth, the tax actually diminishes the likelihood of that occurring.

The results of a recent DRI McGraw Hill study shows that by 1998, less than 1 year after full implementation, the BTU tax will result in a loss of GDP of nearly \$34 billion annually and a corresponding loss in jobs of about 400,000.

For all of these reasons, Mr. Chairman, the API urges you to reject the BTU tax. However, if Congress does move forward with

this proposal, there are a number of design issues which must be addressed and we would hope to work with the Committee in resolving them.

Let me highlight four major problems. Market distortions caused by the BTU tax are a major problem and there are a number of factors that contribute to the distortions.

First, the rate for petroleum is two and one-third times greater than the tax on competing fuels. This means that suppliers will not be able to recover the supplemental oil tax in those markets where oil companies compete directly with natural gas and coal. They will either have to absorb the tax in order to compete or lose market share to other fuels.

Second, the taxation of purchased fuel used to make fuel will force domestically refined products to carry that imbedded cost while imported products will not. To the extent domestic refiners attempt to recover this additional tax cost on gasoline and other transportation fuels, their ability to do so will be limited because similar imported products will bear a fixed rate of tax that does not include this embedded cost.

Two things will occur. Gasoline and other light end product imports will increase and domestic refiner margins will be squeezed even further in order to compete with imports. Both will have a tendency to drive refining capacity off-shore with consequent U.S. job loss and greater product imports.

The third problem, the point of tax collection, is still a major issue. As you can see from the energy flow chart, this tax can be levied at any of a number of locations, each with its own set of complications.

Imposing the tax at the refinery gate poses serious problems for administering exemptions for petro-chemical feed stocks and other non-fuel uses, fuel imports and the reduced rate of home heating oil. This is because the use of many petroleum products is not known until very far down the distribution chain.

Refinery gate tax collection also causes market distortions because of the difference in product transit times and resulting carrying costs. Imposing the tax further downstream, when product breaks bulk at a terminal rack, is crucial to alleviating many of the market distortion problems and would simplify the administration and collection of taxes.

A fourth problem is that the tax rate is indexed to inflation. Over the last 10 years the price of crude oil has fallen 44 percent while inflation, as measured by the implicit price deflator, has increased over 44 percent.

If the BTU tax on crude oil were in effect at the beginning of the period, tax collections from the industry would have increased by almost \$10 billion at a time when industry profits were depressed and, as the Secretary mentioned this morning, 450,000 jobs were lost.

This measure will lead to substantial erosion of real income and cause the loss of thousands of jobs in the oil and gas industry.

The CHAIRMAN. Mr. Beghini, may I just say, we continue to have time here. Please finish your statement. Take your time.

Mr. BEGHINI. I am essentially finished. In summary, Mr. Chairman, the API supports the President's goals, but has strong res-

ervations about the BTU tax. If additional revenues are needed, we suggest that a broad-based consumption tax would be better suited to improving U.S. competitiveness and enhancing long-term growth.

Nevertheless, if the committee moves forward with the BTU tax, we want to work with you to make it less onerous and more manageable. I thank you very much for this opportunity to testify.

The CHAIRMAN. We thank you. You have a different view about where this tax should be collected. You would like to collect it at product terminal, is that what you said?

Mr. BEGHINI. Yes, sir.

The CHAIRMAN. That is a judgment on which I would never dare to presume on my own experience. But a decision has to be made and we very much welcome it. I followed your points and we will get to conversation.

[The prepared statement of Mr. Beghini appears in the appendix.]

The CHAIRMAN. Mr. Ames?

STATEMENT OF EUGENE L. AMES, JR., CHAIRMAN OF THE BOARD, INDEPENDENT PETROLEUM ASSOCIATION OF AMERICA, AND CHAIRMAN, VENUS OIL COMPANY, SAN ANTONIO, TX

Mr. AMES. Thank you, Mr. Chairman. My name is Gene Ames and I am an independent geologist from San Antonio, TX. I am serving a 2-year term as chairman of the Independent Petroleum Association of America. Independent producers actually produce 60 percent of the natural gas in the country and 40 percent of the oil. We drilled about 80 percent of the wells, historically, back when we were drilling wells.

I cannot talk about BTU taxes without talking about people. The effect of the tax as it was originally proposed on millions of Americans and on the economic future was wrong. I am speaking for the roughnecks, the roustabouts on the drilling rigs, the seismic crews, the land men, the geologists, well service contractors, their employees, bulldozer operators, secretaries, others who work in the domestic, natural gas and oil industry.

I am speaking for the tens of millions of people who live in the 33 states which produce gas and oil. Most of their livelihood, and a great deal of their economy and their state tax revenues, comes from national gas and oil resource production.

More than 450,000, as Mr. Beghini and Secretary Bentsen said, more than 450,000 jobs have been lost in this industry. As survivors in this industry, we are ready to go back to work, but we know that further job cuts will come if the BTU tax is added to the totals already assessed against our industry, an industry that was once the nation's largest contributor to the overall economy.

The pictures emerging from the collapse of our industry in the mid-80's are anything but positive. They show a future for domestic oil and gas industry that is frightening. The administration is aware of our concerns. We know that the administration knows about the problems we have had. They supported fine-tuning the BTU tax as it was proposed.

Especially Secretary Bentsen has worked closely with our industry to try to address the concerns about the BTU tax. Many concerns have been addressed. The collection point issue has been somewhat addressed in part. We are grateful for that.

But we really remain confused by the inconsistencies and the market distortion which are still in this tax as proposed. For instance, as Senator Bentsen correctly noted, oil and natural gas consumed on the premises where oil and natural gas are produced was exempted, but not the cost of the purchased fuel and electricity used to run the pumps on most stripper wells.

Totally ignored was the fact that electricity can be more than half the cost of producing marginal oil. We come to you all today as good citizens to try to point out what we sincerely believe are some errors in the government's proposed BTU tax, which must be corrected if it must become law.

The BTU tax will cause a rise in foreign oil imports because the costs of producing the marginal barrels at home will rise. The cost of purchased fuel to produce domestic energy will rise. The cost of transporting drilling rigs and equipment to new sites will rise. So will the price of the 400 to 600 gallons of diesel fuel required daily to operate these rigs rise.

Unfortunately, the one thing we cannot see rising is domestic oil and gas production. If the BTU tax is adopted, we urge you to offset its impact on domestic natural gas and oil production. This should be accomplished through a production-based tax credit for marginal oil and gas wells, a necessity if these wells are to be kept on line.

These marginal oil and gas wells comprise 77 percent of the gas and oil wells in this country, and probably produce over half of the oil and gas produced in the lower 48 states, a very valuable resource to us that must be preserved.

Since the oil price collapse in 1986, tens of thousands of marginal wells have already been abandoned.

I began by telling you my concerns about the future welfare of thousands of workers in this industry whose jobs may be placed in jeopardy by the BTU tax. Let me close by focusing on the signals the BTU tax sends, not only to the industry, but to all America.

If we want to send the signal that natural gas is the cleanest fuel of the future, why not tax natural gas at a preferential rate to all fuels? The double tax on oil is a wrong signal. Pulitzer Prize winner author, Dan Yergin, in his award-winning history, *The Prize*, pointed out vividly the direct correlation between the production of oil and living standards throughout the world.

Oil remains our most vital natural resource.

The CHAIRMAN. Mr. Ames, I am sorry to disturb you. I want you to finish when you are ready. We are not trying to cut you off. You came a long way to get here now.

Mr. AMES. Thank you, Mr. Chairman.

Oil does yet remain our most vital natural resource. And although we must reduce our dependency on foreign oil, we must increase our domestic oil production to do this.

There is a sound, environmental reason for you to consider exempting compressed natural gas from the tax. There are no pesticides used in producing natural gas. The administration proposes

to exempt such a tax on ethanol, why not exempt natural gas as well?

If we do not do something to start our drilling, there may not be enough natural gas in the future. The active drilling rig count in the 33 states is at a record low—603 rigs just last week. At a time when Solomon Brothers estimates that we need twice as many rigs drilling for gas than we have.

There are only 6 rigs active in North Dakota today where there were once almost 150. This is true all over the oil patch. Yet there is great potential for new resources, for developing major gas resources, and 44 states contain potential for oil and gas, an unrecognized but important source of economic growth if we develop it.

Recently, the administration expressed its desire to help the former Soviet Union with its serious financial problems, specifically President Clinton promised Russia millions of dollars to save among other things the infrastructure of Russia's collapsing petroleum industry.

Such a good neighbor policy is needed and commendable. But I must remind the Congress and the President that the infrastructure of the United States oil and gas industry is also collapsing.

In the effort to refocus our effort on domestic issues, do not forget the need to rebuild America's domestic natural gas and oil production industries.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Mr. Ames.

[The prepared statement of Mr. Ames appears in the appendix.]

The CHAIRMAN. And now to hear further about natural gas, Mr. Catell.

**STATEMENT OF ROBERT B. CATELL, PRESIDENT AND C.E.O.,
THE BROOKLYN UNION GAS COMPANY, BROOKLYN, NY, ON
BEHALF OF THE NATURAL GAS COUNCIL**

Mr. CATELL. Thank you, Mr. Chairman, distinguished members of the Committee. I would like to thank you for the opportunity to testify here today.

I am Robert Catell, president and C.E.O. of The Brooklyn Union Gas Company. Brooklyn Union is primarily engaged in the distribution of natural gas and serves nearly 1.1 million customers in an area of New York comprising 4 million residents. We are also engaged in the production and exploration for natural gas.

I am pleased to appear here today on behalf of the Natural Gas Council, a coalition which includes the American Gas Association, the Independent Petroleum Association of America, the Interstate Natural Gas Association of America, and the Natural Gas Supply Association, representing all segments of the natural gas industry. I welcome this opportunity to comment on the administration's proposed BTU tax.

The Council strongly supports the President's commitment to curtailing Federal spending, reducing the deficit and promoting economic growth. In a letter to the President, member Associations of the Council stated they are on record as not supporting energy taxes, but pledge to work constructively with the administration on the unresolved issues in the economic package. We make the same pledge to you.

The BTU tax substantially adds to the average household's annual costs. It will increase gas bills by \$25, electric bills by \$23, gasoline costs by \$76, and hidden costs in goods and services by \$184, for a total annual increased cost of \$310, somewhat higher than the amount mentioned by the Secretary.

We believe there will be regional disparities among amounts consumers will pay.

In addition, contrary to the perception of some, the tax will not increase markets for natural gas. Among other things, natural gas would lose market share to electricity and renewables, such as wood chips, and industrial and commercial applications.

Now let me address the important point of collection issue. The administration's proposal to collect the tax on natural gas, principally at the city gate, in and of itself will increase the tax burden in some states by as much as 15 percent because of piggy-back taxes, such as grocery receipts and sales tax.

Further, the city gate collection point threatens the well-being of all gas companies, particularly gas utilities which may be denied full and immediate flow-through of the tax. The cost of the tax would equal or exceed the annual net income of a large number of utilities and would harm all segments of the gas industry and their customers.

In response to the question which was asked earlier, regardless of where the tax is imposed, some state PUCs will require disclosure of the tax on the customer bill. And a number of gas company C.E.O.s advise us that for prudent business purposes they will inform their customers of the tax to explain the increase in customer's bills.

The best way to structure the tax is to impose it upon the ultimate consumer or end user and collect it from the last seller of gas to that consumer in a manner similar to the Federal Excise Tax on the telephone service. This would not result in any administrative burden. The utility collects the tax and remits it to the Federal Government.

Collecting the tax at the end user level would minimize or eliminate many of the problems associated with the BTU tax.

The CHAIRMAN. Mr. Catell, this is the burner?

Mr. CATELL. At the burner tip, essentially. Right, at the consumer.

Following up on that, this method best achieves the administration's goal of flowing through the tax and reducing the gas company's exposure to absorbing the cost of the tax. The end user collection point could avoid possible conflicts with state and local regulatory authorities in getting the cost of the tax included in customer's rates and it would avoid the need to pre-empt state or local regulatory authority.

Second, the end user collection point reduces the ultimate cost to consumers by avoiding the piggy-back tax on tax. We estimate that a city gate collection point will cause these piggy-back taxes to increase the cost of natural gas to consumers by \$350 to \$400 million annually and the cost to both gas and electricity to consumers by \$1 billion to \$1.2 billion annually.

Many states have these piggy-back taxes, but not all. In the State of New York, for example, the gross receipts tax is 5.61 per-

cent and 2.35 percent in New York City. Additionally, up to 8.25 percent is added to this as sales tax, resulting in a total exceeding 16 percent.

Illinois imposes a gross receipts tax of 5 percent. The City of Chicago adds a municipal gross receipts tax of 8 percent. The State of Texas imposes a 2 percent gross receipts tax on residential users and the City of Houston imposes an additional 4 percent tax.

Again, these extra costs to consumers will not occur if the collection point for the tax is at the end user as we support.

Third, the end user collection provides an administratively simple collection process with minimal collection points and minimizes market distortions. This approach helps meet the administration's stated BTU energy tax objectives, including energy conservation and a clean environment.

If in the final legislation the tax is collected at the city gate, two factors need to be addressed. First, utilities should only be required to pay the pipeline what they collect from their customers. And, second, some mechanism, other than the normalization approach as proposed by the administration, is needed to accomplish pass through.

Lastly, the administration has proposed an exemption for methanol and ethanol in vehicular applications. If this exemption is to remain, the Council feels strongly that the vehicular compressed natural gas should be treated the same as methanol and ethanol. Some members feel that there should be no exemption, but all members feel strongly the treatment should be the same for alternative vehicle fuels.

This concludes my testimony. Thank you very much. I will be happy to answer any questions. Thank you.

The CHAIRMAN. We are following you.

Mr. CATELL. Okay.

[The prepared statement of Mr. Catell appears in the appendix.]

The CHAIRMAN. Mr. Lawson, do you want to wrap up for the producers here?

STATEMENT OF RICHARD L. LAWSON, PRESIDENT, NATIONAL COAL ASSOCIATION, WASHINGTON, DC

Mr. LAWSON. Thank you, Mr. Chairman, Senator Packwood. I am Richard Lawson, the president of the National Coal Association. The Association is a Washington, D.C.-based industry association which represents coal producers and other companies associated with the production, the domestic distribution and the export of U.S. coal.

Our member companies account for approximately 70 percent of the total U.S. coal production and about 80 percent of coal exports. Our members operate mines in all regions of the country, serve all markets, the utilities, steel mills, industrial markets in the U.S. as well as the utilities and steel mills abroad.

Mr. Chairman, despite the fact that several of the provisions contained in the President's economic proposal, certainly including the BTU tax, will impact upon the coal industry, the National Coal Association believes that deficit reduction is the paramount national priority.

We recognize the administration has decided upon a broad-based energy tax and we commend the administration for already recognizing the problems of a tax placed directly on energy production. We are committed to work with the Congress and the administration for the passage of the tax.

We believe the nation has now come to the point where it must address the need to reduce an ever growing deficit and this requirement must override other concern. We believe this means there must be a reduction in spending and, if necessary, an increase in revenue.

And the President, as part of his package, has proposed a combination of spending cuts, initiatives and tax increases, a large portion of which is the revenue identified by the administration to be known as a BTU tax.

In addition to contributing revenue for the overriding objection of deficit reduction, the administration has also outlined several objectives that the energy tax is designed to achieve—promotion of conservation, the encouragement of an increase in energy efficiency, and a reduction and reliance on foreign sources of oil.

To these stated administration goals we add the following goals—that these objectives should not discriminate against individual energy sources in the terms of the amount, the tax should be on all sources of energy, and to the maximum degree possible, the incidents of the tax should be borne by the ultimate consumer of the energy.

And finally, we would suggest that the energy tax should be phased out as soon as the nation's budget deficit reduction objections have been achieved.

So our assessment is that a BTU tax is the form of a broad-based energy tax that best accomplishes the goals outlined above. However, it is our belief that the administration will need to have the collective expertise of private industry, the Congress, as well as its own, if we are to maximize the ability of a BTU tax to accomplish the foregoing stated objectives.

We have attached a list of comments to our printed statement on these comments on the modified tax that we believe deserve additional consideration and work, and we are pledged to continue to work with the administration and the Congress to further enhance the proposals capability to achieve both administration objectives, maintain a level playing field among the energy sources and minimize negative impact on both the domestic economy and upon the international competitiveness of U.S. exports.

With those comments, Mr. Chairman, I will reserve and await your questions.

[The prepared statement of Mr. Lawson appears in the appendix.]

The CHAIRMAN. Thank you very much, General. Just to help me and to satisfy my own curiosity, we export 15 million tons of coal, mostly through the Gulf down in Mississippi. What proportion of eastern coal production is the 15 million tons?

Mr. LAWSON. We export 15 million. That is true. Through the waterway system that leads into the Gulf. I would say that is about 80 percent eastern and 20 percent western.

The CHAIRMAN. Yes. And of our total production, what does it represent? Do we know?

Mr. LAWSON. The total production——

The CHAIRMAN. We don't export energy.

Mr. LAWSON. We export 110 million tons all told.

The CHAIRMAN. Okay.

Mr. LAWSON. About 10 percent of our total production. We produced right at 1 billion tons last year and about 10 percent of that went overseas for about \$4.9 billion worth of positive exports.

The CHAIRMAN. Some of it still goes to Japan, does it not?

Mr. LAWSON. Yes, throughout the Pacific Rim and to Europe.

The CHAIRMAN. And, of course, to Europe. And we have been working on the question of getting you an 80-foot port.

Mr. LAWSON. We are looking forward to that.

The CHAIRMAN. You have been waiting over 15 years. [Laughter.]

And wood chips, I think you mentioned wood chips, Mr. Catell.

Mr. CATELL. Yes.

The CHAIRMAN. Whence cometh wood chips and why aren't we taking them?

Mr. CATELL. Well, I cannot answer the question, Mr. Chairman.

The CHAIRMAN. Senator Packwood will destroy that statement. Is there a significant amount of energy produced? Is it a cost of lumbering? I assume so.

Mr. CATELL. I think there is, yes. And it is growing as part of the effort to use more renewables. Certainly that is growing.

Senator PACKWOOD. It is interesting how history goes in cycles. We are seeing a more co-generation with the use of wood chips. Eighty to ninety years ago, almost all of the mills, the lumber mills, produced their own electricity. There was no central distribution system. Then we had the central distribution system and they quit doing it; and now they are coming around to doing it again.

So it is funny how the cycle goes. Wood chips is one of the principal things they are using.

I want to ask a question about reserves.

The CHAIRMAN. You seem to have gone by the issue, why aren't we taxing.

Senator PACKWOOD. Well, we do not want a tax co-generation.

The CHAIRMAN. I got that. Thank you.

Senator PACKWOOD. Let me ask this of all of you because my hunch is you will all know the answer. When we use the word "reserves" of oil and gas, we are talking about reserves at a given price, aren't we?

Mr. BEGHINI. Absolutely. We are talking about in most instances, reserves that have been found and have an economic life under today's price.

The CHAIRMAN. Does Mr. Ames agree, the geologist?

Mr. AMES. That is absolutely right.

The CHAIRMAN. You mean if the price doubled the reserves would double?

Mr. AMES. Sure. If the price goes up the reserves go up because——

Mr. BEGHINI. They would not double. But they would go up only because the economic life of the well would be extended.

The CHAIRMAN. Is there no term for the physical reality—that there is so much coal in the ground as against what it would pay you to dig it up?

Mr. AMES. Well, there is a finite amount of reserve, resources there, obviously, at any price.

Senator PACKWOOD. But no one knows exactly what it is, do they?

Mr. AMES. Well, you can make some educated guesses.

The CHAIRMAN. Well, they know something.

Mr. AMES. There is a recoverable resource base in the United States, for example, of 1,250 trillion cubic feet of natural gas. That is a resource base. It is undeveloped. In order for it to become reserves, it has got to be drilled and developed.

Senator PACKWOOD. Is that a U.S. Geological Survey estimate?

Mr. AMES. It is a result of the National Petroleum Council's major study on natural gas that was completed this year.

Senator PACKWOOD. Now the reason I am going down this line of questions, and I have not done a lot of research on this subject since we deregulated gas, but at the time we did I went back and I looked at the old U.S. Geologic Surveys and they were forever estimating not the reserves, but the quantity that was there. Am I correct in my memory?

Mr. BEGHINI. Absolutely.

Senator PACKWOOD. And again, I emphasize, not the reserves, just the quantity that was there they were under emphasizing. So is there any reason to assume that their estimate is accurate now?

Mr. BEGHINI. I think you have to accept the fact that they have made their estimate with the best technical knowledge they have at this point in time. As the years go out and technology advances, I am sure that there will be better estimates.

But the tendency of the industry over time has always been to underestimate reserves. In 1970, for example, world reserves developed were 570 million barrels. In 1990, world reserves were 1 trillion barrels. So, obviously, technology does allow new barrels to be developed.

Senator PACKWOOD. Now am I correct, whether it is technology or the deregulation of natural gas, we seem to have found increased, stumbled onto, in North America incredible increases in natural gas.

Mr. AMES. That is in the resource base.

Senator PACKWOOD. Yes.

Mr. AMES. The knowledge of the resource base is greatly expanded because we have improved our ability to estimate. The geology has improved so much with the new technology that you now have a much better, more accurate estimate of what the resource base is that is there. But, of course, resources are not reserves until we drill for it.

Senator PACKWOOD. No, I understand it is not reserves and the reserves depend upon whether in oil you are getting \$10 a barrel or \$50 a barrel and there are a lot more reserves at \$50 a barrel than there is at \$10.

The reason again I am pursuing this, one of our large—well, the only one in Oregon—nuclear plant has been closed and the company is going to phase it out. It has been going 20, 25 years and

it is not worth continuing. They are going to generate with natural gas instead and they have some long-term contracts and figure it is worthwhile. This is not something they would have considered doing 20 years ago.

What has changed that an electric utility can look at this and say, yes, we can get a long-term contract. We think it is viable. We can produce electricity at a modest price, frankly, almost competitive with hydro.

Mr. BEGHINI. I think one factor is that the basic economy of the fuel has allowed the supplier to make that kind of long-term deal. Not knowing the contract, I would not know whether it would be indexed to some deflator.

Senator PACKWOOD. I do not know.

Mr. BEGHINI. But the fact is, I think everyone feels much more comfortable with the fact that natural gas is available in this country and can be developed at an acceptable price.

Senator PACKWOOD. You say in this country. Do you mean in the continental 48 or do you mean North America, counting Canada and Mexico?

Mr. BEGHINI. I am talking about in the continental United States and off-shore.

Senator PACKWOOD. It almost seems as if we ought to quit—not quit worrying about, but quit derating ourselves of being short of energy. We seem to be a cornucopia of energy natural resources, including coal.

I mean, if you want to look at a country that is barren, you look at Japan that does not have any natural resources of any great consequence. And we sit here wealthy beyond belief, at least in the existence of the resources, am I correct?

The CHAIRMAN. Resource based?

Senator PACKWOOD. Resource based.

The CHAIRMAN. Is that the term we use?

Mr. AMES. Yes. The economics have to be there to develop it.

The CHAIRMAN. Well, we know that.

Senator PACKWOOD. I know that. But at least we have the base to develop it.

Mr. AMES. Absolutely. We do.

Senator PACKWOOD. And that we should quit going around crying poor mouth and saying we are running out of energy.

Mr. BEGHINI. In fact, Mr. Chairman, in 1981, 85 percent of the energy used in this country was domestically produced. We imported 15 percent of our total energy requirement.

Senator PACKWOOD. Now let me ask you to separate oil from gas. Mr. Beghini, are you confident—separate if you want continental United States and land-based from continental and off-shore and add North America and Alaska in a separate question—can we expand our recoverable oil resources, not expediential as you have indicated, but significantly in the continental land-based United States with increased prices or there is the resource base running dry.

Mr. BEGHINI. I believe the continental United States has a lot of future involved and primarily in enhanced recovery and looking for smaller fields. That is being done today because we have much better seismic techniques.

Enhanced recovery, whether it be the injection of steam in California, inert gas or carbon dioxide in Texas, or chemicals in some other part of the country, is a very high-cost mode of production. To do that you have to have a price scenario that will allow you to take both the capital risk to initiate it and the ongoing expense risk.

The BTU tax, in particular, when it taxes purchased energy, as is currently proposed, has a very, very detrimental effect on enhanced recovery projects. But there is a great deal of opportunity in this country to maintain and expand our energy base.

As Gene mentioned earlier this morning, we have an immense number of stripper wells that we must in some form keep operating so that we can apply enhanced recovery techniques to these fields. Those wells will be there.

Senator PACKWOOD. Expand your judgment—and, Mr. Ames, hop in on this if you want—expand your judgment on the resource base to include all of North America, including Mexico and Canada, which I hope will all be soon trading and Alaska and off-shore. If we do that, do we have a significantly expandable base of oil?

Mr. BEGHINI. Yes, we do, sir.

Mr. AMES. Yes, sir. Arco has just announced two major discoveries in the last year or so in Alaska in the Cook Inlet and north of Anwr that are in the 1 to 5 billion barrel category, giant fields.

There is a major new discovery, of all places, in North Dakota, that has just been completed that is capable of flowing—

Senator PACKWOOD. I am not sure that Senator Conrad would agree with your description.

Mr. AMES. Well, pardon me, Senator Conrad, but North Dakota has used—

The CHAIRMAN. Better than ethanol?

Mr. AMES. It is 4,000 barrels a day of oil. That well will flow 4,000 barrels a day of oil. It is like a Saudi Arabian well and it is in an area that had very little deep drilling.

Senator PACKWOOD. Is this close to the surface or not? I am curious.

Mr. AMES. It is about 10,000 feet deep.

Senator PACKWOOD. Is that close or not?

Mr. AMES. Well, it is intermediate.

Senator PACKWOOD. Is it? Okay.

Mr. BEGHINI. It would not be considered deep.

Senator PACKWOOD. Okay.

Mr. CATELL. If I could just follow on, Senator Packwood. In addition to the oil reserves, as was mentioned by Gene, I think we have confirmed the tremendous resource base for natural gas. We thought many, many years ago we were running out of natural gas. It is just not the case. At the right price it can be developed.

Following on your electric generating plant, one of the reasons is the resource base is there and a gas plant can be built in a fairly short period of time at a reasonable price; and gas obviously is an environmentally clean—burning fuel. So it has all of those advantages as well.

We have a tremendous resource base of energy in this country and we are concerned that the BTU tax could have a detrimental effect on some of that.

Senator PACKWOOD. I have the same concern and I am glad you confirmed what I intuitively thought, that we are not resource poor. We may choose to tax it out of existence or we may pass laws that say you cannot drill for it. But that is not the same as being resource poor.

Mr. LAWSON. If I may, Senator, perhaps I can add to that. America happens to be the Saudi Arabia of coal. The fact is, we are better than the Saudi Arabia. They have about 28 percent of the world's oil. We have 36 percent of the world's coal, 488 years worth at our current production—488 billion tons that is economically—

Senator PACKWOOD. At our current production and that does not stretch the limit of what you could produce.

Mr. LAWSON. Not at all. And that is all economically recoverable. The resource base is about 3.4 trillion tons. So there is a huge energy stockpile right there, immediately available, to begin to put pressure on some of these imports as well as to continue with the export of the commodity.

Mr. AMES. May I make one statement?

The CHAIRMAN. You can make as many statements as you would like.

Mr. AMES. Mr. Chairman, we are very lucky we have this resource base. But independent producers who historically have drilled 85 percent of the exploratory wells in this country have no outside capital for drilling. That is our problem. It is not the problem of resources.

The CHAIRMAN. Mr. Ames, you can clarify something for me. When I first came on this Committee, which was many, many years ago, these independent producers you describe were referred to as "grandma." Grandma was a firm or something that always had a stripper well in the backyard. I do not know where it was.

Do you have grandma firms?

Mr. AMES. Yes, sir. Ma and pa.

Senator PACKWOOD. I have no further questions.

The CHAIRMAN. Well, I found this very revelatory in terms of the resource base. I would also say that with our current consumption of coal, we have half a melania worth left. If we cannot get diffusion by then, then we have to give up anyway. [Laughter.]

Could I say that several points have been made about where this tax is most efficiently collected if it is to be imposed. And may I say you have all argued—I am not a lawyer, but I have learned from my colleague here the technique of arguing in the alternative. I believe I heard some of that. My client did not shoot his wife; or alternately, Your Honor, if he did shoot his wife it was accidental. [Laughter.]

We will pay very close attention to these questions and we will consult with Secretary Bentsen. We very much appreciate your coming. And we will be in touch with you.

Senator PACKWOOD. Thank you.

Mr. AMES. Thank you very much.

Mr. LAWSON. Thank you.

Mr. CATELL. Thank you very much.

Mr. BEGHINI. Thank you very much, Mr. Chairman.

The CHAIRMAN. We thank our guests and we thank our reporter. We adjourn this first hearing.

[Whereupon, at 12:45 p.m., the hearing was adjourned.]

[The prepared statements of Senators Malcolm Wallop and Orrin Hatch appear in the appendix.]

ADMINISTRATION'S ENERGY TAX PROPOSALS

THURSDAY, APRIL 22, 1993

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, DC.

The meeting was convened, pursuant to notice, at 10:05 a.m. in room SD-406, Dirksen Senate Office Building, Hon. Max Baucus presiding.

Also present: Senators Rockefeller, Conrad, Packwood, Chafee, and Grassley.

OPENING STATEMENT OF HON. MAX BAUCUS, A U.S. SENATOR FROM MONTANA

Senator BAUCUS. This hearing will come to order. This is the second of two hearings on the administration's energy tax proposals. Today, we have three panels of witnesses. The first panel is made up of representatives from essentially the environmental sector. The second panel will consist of representatives of the electrical sector of the energy industry. And the final panel represents a cross section of American industries including agriculture, manufacturing and transportation.

This is an opportunity for various individuals and various groups to comment on the administration's proposed energy tax. There will be hearings on other tax proposals in the future. As I said, this is the second of two hearings so far on the energy tax proposals.

I would just like to outline the procedure for everyone. Essentially, each witness will be limited to five minutes. Testimony will be included in the record, and I would encourage witnesses to summarize the testimony and basically take it from there.

The first panel is Melanie Griffin, Washington director for the Economic Program, The Sierra Club; Roger Dower, program director, World Resources Institute; and John Hemphill, executive director of the Business Council for a Sustainable Energy Future.

Why don't all three of you come up to the witness table?

Melanie Griffin, why don't you begin?

STATEMENT OF MELANIE L. GRIFFIN, WASHINGTON DIRECTOR, ECONOMIC PROGRAM, THE SIERRA CLUB, WASHINGTON, DC

Ms. GRIFFIN. Thank you. Good morning, Mr. Chairman and members of the committee. Thank you for this opportunity to share the views of the Sierra Club on the administration's proposed BTU energy tax.

I am here today on behalf of the 600,000 members of the Sierra Club, and I am also representing the Natural Resources Defense Council, the Union of Concerned Scientists, and Friends of the Earth.

The Sierra Club has long been interested in the use of tax policy to protect the environment, and we are very encouraged by the recent activity in this area. U.S. tax policy has historically encouraged polluting industrial activities and natural resource exploitations. It is time to reverse this trend and begin to use tax policy to encourage pollution prevention and energy efficiency and conservation.

To that end, Sierra Club joined with other environmental groups in suggesting that President Clinton include an energy tax in his plan for economic recovery. When the President presented his economic program, we were very encouraged to see that he had, indeed, included an energy tax. While not perfect, the President's tax proposal represents a good first step towards reducing our wasteful use of polluting energy.

External energy costs, in the form of air and water pollution, land destruction, oil spills, and military risks, are already being borne by the American public. These costs could pale in comparison to the future costs of global warming and nuclear plant decommissioning and waste storage. It is time to begin to incorporate these societal costs of energy into the market pricing of energy. Let us put the costs where they belong.

Energy taxes can also give U.S. industries the push that they need to fully explore and implement energy efficiency measures and renewable energy sources. Unlike Japan and several western European nations, the U.S. has done little to foster international exports of these technologies.

As the international community begins to confront global warming, the U.S. must take back the lead in developing and marketing these technologies if we are going to remain competitive. Even after the administration's BTU tax is fully implemented in 1996, prices for all energy sources in the U.S. will still remain lower than our European and Japanese competitors.

We believe that the BTU tax approach, with exemptions for emerging renewable energy sources, is an appropriate framework on which to build. The extra surcharge on oil recognizes that our country bears many societal costs as a result of our oil addiction.

The President's proposed BTU tax is set at very modest levels. It is important to note that the positive environmental effects of the tax are enhanced by other environmental initiatives contained in the administration's budget resolution, and in his proposed economic stimulus package.

When the tax revenue is recycled into programs such as Federal Energy Management, Public Transit, Weatherization, and Renewable Energy Development, the environmental benefits rise substantially.

The administration was careful to provide offsets for families with lower incomes: increased Food Stamp programs, Low-Income Home Energy Assistance Program, and the Earned Income Tax Credit should ensure that low-income families are not burdened.

We must also take into account the fact that energy pollution itself is very regressive. Disadvantaged communities bear much of the burden because polluting operations, like coal-fired power plants and nuclear waste facilities, are likely to be located in low-income areas.

Another attractive aspect of the President's BTU tax is that all energy consumers can legally avoid paying the tax and simultaneously help the environment. An industry can invest in more efficient motors, a business can invest in efficient lighting systems, and homeowners can add insulation. Commuters can opt to use public transit, or purchase more fuel-efficient vehicles.

Overall, the administration has proposed a well-designed energy tax. We do have serious concerns, however, with a number of changes in the proposal, as reflected in the modified BTU tax released by the Treasury Department April 1st.

We believe that all forms of energy used should be taxed, with the exception of emerging, truly renewable energy sources, like solar and wind power. Each exemption provided for an industry or a fuel source compromises the environmental integrity of the BTU tax, and it also risks regional equity.

And, of course, at some point the revenues generated by the tax plan will be seriously reduced by multiple exemptions. The BTU now contains special breaks for alcohol fuels, municipal solid waste, enhanced oil recovery, home heating oil, and more. We believe this is bad environmental and fiscal policy. There's no environmental justification for these exemptions, and we fear that the door is now open for exemptions for other special interests, whether it be aluminum, or hydroelectric.

Exemption for non-fuel sources of fossil fuels is potentially a giant loophole through which revenue and pollution could flow. We urge the committee to give very careful consideration to the feedstock exemption to ensure that only the percentage of the fuel that is really used for non-fuel purposes is exempted. We strongly urge the committee to resist further exemptions. The environmental balance of the tax has already been damaged by existing exemptions.

Finally, a few points on who pays, and where. A major goal of the environmental community is improving energy efficiency in all sectors of the economy. Thus, we believe that all energy users should bear the added costs of the energy tax. The tax should be assessed and incorporated as a cost of doing business at every point in the production and distribution process. It should be assessed as far upstream as possible to encourage efficiency throughout the entire production process, including refineries and pipelines.

We oppose a forced passthrough of costs by electric utilities to ratepayers. While end users should bear some of the costs of the energy tax, they should not automatically bear the brunt. Homeowners can make some efficiency choices to reduce their bills, but they cannot switch fuels or make efficiency improvements for their utilities. States already have provisions to allow utilities to pass-through legitimate costs, and this process should not be overridden.

Thank you again for the opportunity to testify.

Senator BAUCUS. Thank you very much, Ms. Griffin.

[The prepared statement of Ms. Griffin appears in the appendix.]

Senator BAUCUS. Next, Roger Dower.

**STATEMENT OF ROGER C. DOWER, PROGRAM DIRECTOR,
WORLD RESOURCES INSTITUTE, WASHINGTON, DC**

Mr. DOWER. Thank you, Mr. Chairman, and members of the committee. I'm Roger Dower, Director of the Climate, Energy, and Pollution Program at the World Resources Institute, a public policy research center specializing in international and national environmental issues.

Senator BAUCUS. Do we have a statement from you?

Mr. DOWER. Yes, you do, sir.

Senator BAUCUS. I do not have one. [Pause]

Mr. DOWER. I want to thank this committee for the opportunity to be here this morning on behalf, and that of my colleague, Dr. Robert Repetto.

In my brief oral comments, I would like to share with you what I think are three closely related points derived from our work on energy prices and pollution taxes that relate to the Clinton administration's energy tax proposal.

As the energy tax debate turns ever more frequently to what or who gets exempted and where the tax should or should not be placed, it is easy to lose sight of the broader context in which I think this proposal should be evaluated. I hope that my few general observations this morning will help refocus some of that attention and help guide your deliberations and debates. So, let me begin.

One, unless you really think that credible deficit reduction can occur without raising revenues, the energy tax proposal has to be compared to other forms of raising funds. It is not useful or appropriate to compare a broad-based energy tax to nothing else at all.

From this comparative perspective, a properly designed energy tax has several distinct advantages. Virtually all traditional ways of raising Federal funds, such as taxing income, savings, payrolls, and capital, impose significant and very real costs on the economy. These taxes tend to discourage precisely those economic activities that I think most of us feel are important to our National economic health and welfare, such as savings, investment, and employment.

A broad based energy tax, on the other hand, can be designed to have the opposite effect, to discourage activities that hurt the economy, such as pollution and over-reliance on imported oil. Taxes that reduce these activities will create economic benefits and avoid the costs of distorting the economy associated with most other taxes. All taxes raise revenues, but few can create environmental and economic benefits at the same time. As we seek to create a strong economic future for this country, it is critical that we look to revenue sources that work for us, not against us.

Two, as this committee considers the economic impacts of an energy tax, I hope you will again ask the question, the economic impacts, as compared to what? I know of no real—and I stress, real—deficit reduction options—spending cuts or revenue raisers—that do not have some depressing effect on the economy in the short run. Energy taxes are no exception in this regard.

This observation, however, ignores the fundamental economic justification for undertaking deficit reduction in the first place: improved long-term economic health through lower interest rates, increased investment, and enhanced productivity.

These beneficial economic effects of deficit reduction are likely to overwhelm any short-term economic effects of an energy tax. Yet, most economic simulations that I am aware of an energy tax do not take into account these economic gains.

This point, I think, is particularly important as you consider concerns over international trade and competitiveness. Reductions in long-term interest rates and a healthier U.S. macro-economy will have trade enhancing effects that far outweigh any loss in competitiveness that might result from very small increases in production costs associated with this tax. If we have to borrow less from foreign sources to finance our deficit, our trade balance will improve. As we show in our written testimony, there is little evidence that low energy prices are a prerequisite for a strong balance of trade.

Finally, it is important not to forget the potential environmental benefits of a properly designed energy tax. Our Nation's energy sector, even with existing regulations, continues to be a major source of air pollution in this country. The impacts go far beyond our own boundaries. For example, the U.S. is the single largest source of carbon dioxide emissions, a major greenhouse gas, in the world.

The environmental costs of our current energy consumption and production decisions are very real. Yet, to the extent that the energy tax reduces these costs, there are benefits to this tax that are unlikely to be included in any of the economic impact analyses that will be presented to this committee.

I am fairly confident that a larger tax or a tax that is more pollution specific, like a carbon tax, could create larger environmental benefits than the administration's proposal.

On the other hand, there are still environmental benefits from this tax that are not insignificant. I think you will find, for example, that the administration's energy tax proposal, even at its relatively low level, will play an important role in helping this administration meet its international commitment, announced by the President yesterday, to stabilize greenhouse gas emissions by the year 2000 at 1990 levels. Ignoring these benefits is to ignore a key function of the tax.

Mr. Chairman, a broad-based energy tax that helps to reduce the environmental and other costs of energy use offers the opportunity for this committee to take a small step towards a tax system that works for the economy and the environment, and not against them. An energy tax, as proposed by the Clinton administration, can mark the beginning of a fundamental change in the way we use the Tax Code to create revenues and economic opportunities. I hope this possibility will not go foregone because, I'm afraid, using a tired cliché, we fail to see the forest for the trees.

Thank you, Mr. Chairman.

Senator BAUCUS. Thank you, Mr. Dower.

[The prepared statement of Mr. Dower appears in the appendix.]

Senator BAUCUS. Next, John Hemphill.

STATEMENT OF JOHN G. HEMPHILL, EXECUTIVE DIRECTOR, BUSINESS COUNCIL FOR A SUSTAINABLE ENERGY FUTURE, WASHINGTON, DC

Mr. HEMPHILL. Good morning, Mr. Chairman. My name is John Hemphill. I am executive director of the Business Council for a

Sustainable Energy Future. I appreciate the opportunity to appear here today to present the Business Council's views on the administration's proposed energy tax.

Business Council for a Sustainable Energy Future is a newly-chartered organization comprised of business leaders from the energy efficiency, renewable energy, natural gas, and utility industries that share a commitment to pursue a new energy strategy for the 1990's and beyond through the rapid deployment of efficient, non- and low-polluting energy technologies.

Expanded reliance on these technologies as the three pillars of an energy strategy will strengthen the economy and enhance the environment. We believe that President Clinton's economic package signals a major change in national energy policy: the recognition of the need to transition to clean, efficient energy resources. The Business Council welcomes this change in direction.

Although we have interest in many provisions of the administration's proposed economic package, my testimony today will focus on the broad-based energy tax.

President Clinton has proposed an energy tax designed to raise more than \$20 billion when fully phased in. According to the administration, in addition to raising revenues, the energy tax will encourage conservation by making energy more expensive, reduce pollution, and decrease the country's dependence on foreign energy suppliers. The Business Council supports these goals.

While members of the Business Council may have preferred other tax formulations, we recognize that no approach is without criticism. The Business Council is ready to support the administration's energy tax proposal, in recognition that this tax is an important step in the direction of a sustainable energy future. In particular, we applaud the exclusion of renewable energy resources from the tax.

The Business Council does have some concerns, however. First, the tax will have only a modest result in encouraging energy conservation. Because of this modest impact, we feel that it may be appropriate to provide energy tax credits to consumers to further enhance energy conservation that would not otherwise be achieved.

Second, although we support the tax as currently structured, we recommend that serious consideration be given to adjusting this tax at some future date to better support the administration's goals of overall energy and economic betterment.

Third, the Business Council has concerns over the administration's proposed collection of natural gas at the city gate. Applying the tax at this point would expose the natural gas industry to unwarranted financial risk. A similar situation existed with respect to independent power producers that have long-term, fixed-price contracts. And, in this case, the administration came up with a solution by moving the collection point to the exit end of the power plant, rather than having it be taxed on the fuel inputs.

This approach helps to ensure that the tax is borne by the ultimate consumer, and is consistent with the Business Council's principles of having the tax be applied to the consumer, thereby maximizing the environmental and energy efficiency benefits.

The natural gas industry has proposed a similar solution to this collection point problem, namely, that the tax should be assessed

on the end user of the gas and collected by the seller. We urge that you adopt this solution to the collection point issue.

Fourth, we would like to point out our displeasure with some of the exemptions that are being proposed, specifically, the exemptions on ethanol and methanol, from the energy tax. These exemptions discriminate against compressed natural gas, which is in direct competition with these fuels.

Finally, I would like to address an implementation concern of some of our members. The administration is proposing to exempt non-fuel use of fossil fuels, including natural gas liquids. Under the administration's proposal, the tax on these liquids is to be collected at the processing plant. Imposition of the tax at the processing plant, however, would have an unintended effect of taxing feedstock fuels due to the fact that a high percentage of these products are used as feedstocks. The solution to this problem is a simple. Impose the tax at the point these products are odorized for commercial fuel use.

In conclusion, the Business Council believes that the country needs to follow a new energy path for economic, environmental, and security reasons. The Business Council views the broad-based energy tax as a good first step, and we stand ready to work with you on this issue.

Thank you very much.

Senator BAUCUS. Thank you very much, Mr. Hemphill.

I have a question that I suspect Senator Packwood has, with respect to hydropower. This focuses on the northwest, or, specifically, the aluminum industry. I would think that you would agree that hydro is a renewable source of energy and does not damage the environment, not the air and water, and so forth, compared with other fuels. I am just curious if you would generally agree with that.

Ms. GRIFFIN. Well, again, we do support the exemptions for renewal sources. But, for emerging renewable sources—and hydro is a very mature industry and it does not need the extra boost. And, also, we think from the equity standpoint, that a lot of hydropower is federally subsidized.

And, in order to keep the tax equitable across the country, I think it is important to keep those. It would not be fair to raise the rates on other folks and not on the people who are already paying lower rates than the national average. And, of course, as you have said, hydropower does not contribute to air pollution problems, but it certainly does contribute to some water problems, and to riparian habitats, and to fisheries, and so on.

Senator BAUCUS. As I understand it, the BTU tax on hydro is three times what it should be, since the national average of BTU is actually three times that of hydro. Some people suggest that, for that reason, too, hydro should be exempt.

Ms. GRIFFIN. But we would not support that.

Senator BAUCUS. What about the aluminum industry, some kind of feedstock exemption for the aluminum industry, do you have any views on that?

Ms. GRIFFIN. Well, we do. The aluminum industry—the feedstock exemption—this is what I was referring to—really needs careful consideration because we want to make sure that only the actual

portion of the fuel that is used for non-fuel purposes and actually becomes physically incorporated into the final product is exempted.

And, in the case of aluminum, the energy is used for a process, aluminum smelting, a chemical process, but it is not actually incorporated into the final product. So, we would not think that that deserves a feedstock exemption.

Senator BAUCUS. I am just a little bit curious. On the one hand, the environmental community wants the collection point to be closer to the source, thereby, arguably, encouraging a utility to choose a less polluting fuel. On the other hand, the more that occurs, the less consumers are involved in making choices of whether they can consume energy or not. That is the kind of point, I think, to some degree, that Mr. Hemphill made.

Would you not want the collection point more toward consumers so the consumers can then decide whether they want to consume energy or not consume energy?

Ms. GRIFFIN. To some extent, it is going to end up on them in the end. But I think it is really important that we already have State laws that allow the passthrough of legitimate costs, and we think that those ratepayer activities should continue. But, certainly, we think that the utilities are the ones who can make the decisions to actually switch fuel or make major efficiency investments. The homeowners and residential folks cannot make those decisions for the utility, so I think it is important that everyone pays the price to help the economy.

Mr. DOWER. Mr. Chairman, may I give a more general answer to that? One of advantages of thinking about a broad-based energy tax—this particular tax or other taxes—as an economic incentive to encourage environmental gains, is the fact that it encourages environmental reductions at all points in the market, both from the production side and the consumption side of the market, and tries to find ways of creating incentives for cost-effective reductions on both ends.

And, from that extent, you would want to have the tax as far back as possible so that where there are production efficiencies to be gained, or fuel switching efficiencies to be gained, those are taken advantage of, or the prices are passed to consumers so that we get all of the price responses, not just some of them.

Senator BAUCUS. What is there to be learned from Europe? My vague understanding is that Europe has basically a consumption tax system. It has high gasoline taxes which are designed, to some degree, to stifle, I guess, energy consumption. That revenue is then used for various purposes. Europeans, essentially, as I understand it, do not have a BTU tax.

Can any of you kind of generally give us some guidance and educate us a little bit on what the European system is, and what lessons can be learned from theirs?

Mr. HEMPHILL. I am not sure whether the Europeans, in fact, have a BTU tax, per se. But you are correct, they do tax a number of forms of energy. In particular, one of the more visible ones, is the tax on motor fuel, which is very high and obviously has a very positive effect in terms of the efficiency of the European fleet relative to that of the American automobile fleet. So, I guess there is

some empirical evidence that energy taxes are an effective tool in terms of encouraging energy conservation.

Senator BAUCUS. That is on the consumer.

Mr. HEMPHILL. That is correct. But the point that is being made here is that in theory, you are going to get more efficiency by having the tax as far upstream as possible, thereby capturing all the efficiency in the use of the fuel.

Our concerns are with some of the practical problems with the theoretical imposition of the tax as far upstream as possible, in that we have both contractual and regulatory constraints to those flow-throughs of taxes, and that is where practical problems kind of intervene with the theoretical ideal of having it further upstream.

Senator BAUCUS. Thank you.

Senator Packwood.

Senator PACKWOOD. Yes. I want to follow up on the aluminum answer, because I do not quite understand it, Ms. Griffin. You say, "I reiterate that we oppose any exemption for the aluminum industry. The proper way to determine whether energy is actually being used as a non-fuel source is to test whether the chemical elements in the fuel are present in the final product." By that, I take it you mean, if you use oil and turn it into plastic, if there is some portion of oil in the plastic, that would be exempt, in your judgment, as a feedstock.

Ms. GRIFFIN. Right. If the hydrocarbons in the——

Senator PACKWOOD. In the product itself.

Ms. GRIFFIN. Right.

Senator PACKWOOD. But aluminum is one of the few things I have some modest experience in. I worked one summer as a potman 40 years ago.

Senator BAUCUS. That is exactly right.

Senator PACKWOOD. That was the hardest work I ever did, I think. I lost 11 pounds in 7 days.

Senator BAUCUS. That is exactly right. That is the hardest job I ever had.

Senator PACKWOOD. Yes. God, it was tough. But, what you have got are these gigantic rods and you are running the electricity through the melt the bauxite, and the electricity is obviously not part of the final product. And you are saying, unless you physically can have it as part of the final product, it does not count for any kind of a credit, even though it is an incredibly disproportionate portion of your cost.

Ms. GRIFFIN. That's right, because it is not included in the final product.

Senator PACKWOOD. No, I understand it is not. And that is your test.

Ms. GRIFFIN. That is right.

Senator PACKWOOD. And the fact that the aluminum industry is, by and large, a very portable industry—most of the raw material they use is not produced in Montana, or produced in Oregon and Washington; a lot of comes from Jamaica, a lot of it comes from overseas—you can just as well go anyplace that electric rates are such that you can smelt it. And you are suggesting that you would

give no heed to the extraordinary portion of the cost, to the aluminum industry, of electricity?

Ms. GRIFFIN. Well, that is right. I think, in effect, that is what we are talking about. Very energy-intensive industries would have even more incentive to increase their efficiency because their percentage is going to go up higher than other industries.

Senator PACKWOOD. Oh. I understand that. But, until we literally invent a new process—and maybe we will 1 day—the smelting process is tremendously energy-intensive. And the aluminum industry has, indeed, increased its productivity over the years, but it still is going to use a tremendous amount of electricity, no matter how productive it becomes, because it is such a basic element of its process.

Ms. GRIFFIN. Well, the administration estimates that the costs could go up 4 percent for the aluminum industry.

Senator PACKWOOD. Yes.

Ms. GRIFFIN. And I think that that would give them, as I said, even more incentive to try and find more efficient ways to do the smelting process.

Senator PACKWOOD. Mr. Hemphill, tell me a little bit about your organization. How old is it?

Mr. HEMPHILL. We were established in December of last year, so we are a very new organization.

Senator PACKWOOD. And tell me some of the companies or industries that belong to it.

Mr. HEMPHILL. We have Enron Corporation, essentially a pipeline and natural gas marketer.

Senator PACKWOOD. Yes.

Mr. HEMPHILL. Southern California Edison, Southern California Gas, Northern States Power, are some of the utilities that are members. Honeywell.

Senator PACKWOOD. Is a fair portion of the natural gas industry members supporting it?

Mr. HEMPHILL. No. We have, in total, 30 members, of which maybe one-third, thereabouts, are in the gas business. So, we have on the order of 10 or so that are in natural gas, including all phases. We have some small producers that are members, as well as pipelines and local distribution companies.

Senator PACKWOOD. All right. Let me ask a further question, Mr. Chairman. The day before yesterday when Secretary Bentsen, and then people from the coal industry, the natural gas industry, and the oil industry testified, their uniform conclusion was—forgetting the environmental argument for the moment—we have an almost inexhaustible supply of what you would call non-renewable energy sources. Would you agree with that?

Mr. HEMPHILL. We have a large supply of energy sources, including natural gas: coal, even oil, although not sufficient to meet our domestic needs.

Senator PACKWOOD. No. But we are an immense oil producer, in any event.

Mr. HEMPHILL. Right.

Senator PACKWOOD. Let me ask the other two, would you agree with that statement?

Mr. DOWER. It depends on what one thinks is exhaustible. We have large quantities of economically recoverable coal in this country, there is no question about that. Oil and natural gas are exhaustible on an economic basis, and we are seeing that in the oil fields in this country. But we have a lot of coal.

Senator PACKWOOD. Right.

Mr. DOWER. We also have a lot of wind, a lot of solar. We have a lot of other sources of energy as well.

Senator PACKWOOD. But what I mean is, absent the environmental argument, if we had to depend on what would be defined as exhaustible resources, we could go several centuries without running out.

Mr. DOWER. I suppose that that is right, absent the environmental concerns.

Senator PACKWOOD. Right.

Mr. DOWER. We have coal.

Senator PACKWOOD. And I say, in comparison to Japan that does not have much in the way of natural resources, they have no choice but to import most of their energy because they just do not have any natural resources.

Mr. DOWER. That is true.

Senator PACKWOOD. Would you agree, Ms. Griffin?

Ms. GRIFFIN. Well, not in the case of oil, no, especially the rate that we use it, I do not think that we have that much time left. But it is hard for me to forget the environmental arguments. If you talk about economically recoverable and you do not think about the environment, and then you think about how much we are going to have to bend to counteract the effects of global warming, who knows, 10, 20, 50 years from now, I do not think you can forget those things when you are talking about energy supply.

Senator BAUCUS. Senator Rockefeller.

OPENING STATEMENT OF HON. JOHN D. ROCKEFELLER IV, A U.S. SENATOR FROM WEST VIRGINIA

Senator ROCKEFELLER. Thank you, Mr. Chairman.

There are two points that I would make, and neither comes in the form of a question. All of this discussion in this hearing and others that we are having, including the votes with regard to the stimulus package—all of it, have to do with the economy and fundamentally reducing the budget deficit. That is the thrust, basically, of all that we are doing here—the reduction of the budget deficit.

It is just interesting for me to note—and I would have made this observation at the hearing with Secretary Bentsen, and, I am sure, would have had his total agreement—that if we do everything that is being contemplated, not just energy taxes, but other taxes, budget cuts, the stimulus, which we now will not be doing, but other things that we will be doing—that the budget deficit—would begin again immediately rising again in 1997 due to health care costs. The taxes that we are talking about, BTU, any other kind, will have a negligible effect on the budget deficit long-term—by long-term, I mean within 4 years—leaving us right back where we are now unless we pass health reform legislation.

The point I want to make is that, unless we pass all of the health care reform legislation this year, in that it will take several years for that to be implemented, pass all the implementing legislation this 1993 year, and do the cost containment that goes along with that, along with the coverage phased in that goes along with that, unless we do that this year, all of this discussion, BTU tax, all the rest of it, makes no difference whatsoever because the deficit continues to climb back up.

And it is only health care reform in combination with, linked inextricably to what we are discussing here today, and all of the other parts of the economic plan that will allow the country to get the deficit under control. And this is very, very clear. And I just wanted to make that statement. Since this meeting has nothing to do with health care, I felt it was particularly appropriate for me to make it. [Laughter.]

But I make it with a good deal of tenacity because there is kind of a word going around, primarily based on the fact that the health care package has not been produced. The press does not have very many good news stories, so they are kind of wandering around and asking people, do you think health care can pass this year? It is probably a lot easier to say no than to say yes, because if you say no, that means if it does you look good, and if you say yes and it does not, you do not look so good. So, I just thought I would interject that into the conversation this morning.

None of this means anything—anything—for the American economy without doing health care reform this year. All of the partisanship of both sides that were observed by this Senator, at least, in the last several weeks over the stimulus package are going to have to disappear and lessons are going to have to be learned by both parties that those kinds of games cannot be played when we are talking about the American people.

Now, that has nothing to do with any of this, but has everything to do with all of this. I wanted to make that point, Mr. Chairman, and also put my statement in the record.

[The prepared statement of Senator Rockefeller appears in the appendix.]

Senator ROCKEFELLER. And, also, agree, as I know the Senator from Montana will give you the liberty to do so, when Secretary Bentsen indicated on Tuesday that the relative impact of the BTU tax on western coal and eastern coal, he indicated this was not a problem. The Congressional Research Service has reached a similar conclusion. This has to do with the relative impact of the BTU tax on eastern versus western coal. I want to submit for the record, also, the Congressional Research Service study which shows that to be the case.

[The prepared study is retained in the committee files.]

Senator ROCKEFELLER. That was just a statement, Mr. Chairman. You raised your hand.

Ms. GRIFFIN. Yes. Can I comment? I think that it sounds as if what you are saying about health care does not have much to do with what we are talking about today, but if you look at the health care costs that we pay because of our energy use, particularly directly the air pollution costs—the American Lung Association has

estimated billions and billions of dollars because of health care damage due to air pollution—I think it is connected.

Senator ROCKEFELLER. It surely is. It surely is. You are exactly right. It is connected, both in health care terms vis-a-vis what we are talking about, and in terms of what the Congress has to do this year: both packages this year.

Thank you, Mr. Chairman.

Senator BAUCUS. Thank you, Senator, for your first statement, as well as your second.

At the risk of prolonging this hearing this morning, I just have a basic question. How much is this BTU tax going to, in fact, improve our environment? I mean, none of your statements quantified anything. How much is it going to reduce CO₂; how much is it going to reduce nitrous oxides in the atmosphere; how much is it going to reduce CFCs; how much is it going to reduce the greenhouse gases; how much is it going to, in fact, reduce contaminants in our rivers, our lakes, and our streams; how much is it going to reduce pressure on landfills, incinerators, and so forth?

I mean, there is a lot of theory here and a lot of high-sounding words. But, to be honest about it, I have not heard much that is quantified here in any of the various areas of the environment. Do any of you have any data or any studies that could go to any of that? All your statements this morning were, gee, this sounds good. That does sound good. But is it good, and how good is it?

Mr. HEMPHILL. We have some assessments of the impacts, and I, unfortunately, do not have the information with me, but I would be glad to get that to you. They do have positive impacts on reducing the demand for fossil fuels—modest but measurably positive impacts—and correspondingly positive impacts on the various forms of pollution. We do not have estimates of pollution reduction, but we do have estimates of the shift of energy use. One could calculate or estimate emission reductions from the estimated reduction in fossil energy use.

Senator BAUCUS. You have quantified the fact of fuel switching, say?

Mr. HEMPHILL. We have estimates. Yes.

Senator BAUCUS. You believe the utility will undertake that as a consequence of that.

Mr. HEMPHILL. Yes, sir. We do.

Ms. GRIFFIN. I think, also, part of that depends on what you all do with the tax and how it is designed, and the collection points, and the exemptions, and so on.

Senator BAUCUS. Under the modification that the administration proposed.

Ms. GRIFFIN. Well, the American Council for an Energy Efficient Economy has estimated that it could reduce our energy use by 2 percent, which does not sound like a giant number. But, if you think of it as, like, 35 fossil-fuel fired power plants, that is going to reduce a lot of controversial local power plant siting issues, and also protect public health because of our increases in efficiency instead of using more fossil fuels.

And, again, it is really important to note that this is part of the whole economic package, and we were very disappointed to see the environmental components of the stimulus package go down be-

cause it did include weatherization, Federal efficiency, public transit, and a lot of other things that really complemented the energy tax and would have made it work better. We are hoping to see some of those revived, and, of course, some of the subsidy cuts that are in the budget reconciliation as well will help enhance the effect of the tax.

Senator BAUCUS. Senator Packwood.

Senator PACKWOOD. I am surprised—I do not know about Mr. Hemphill's group, but the other two—that you did not come here more strongly testifying in favor of a carbon tax instead of supporting the BTU tax, which I find a difference from what I think your traditional position has been. Why is that?

Ms. GRIFFIN. I guess you would call it reality. We do support a carbon tax and a higher gasoline tax.

Senator PACKWOOD. Would you prefer a carbon tax that would raise the same amount of money as this BTU tax?

Ms. GRIFFIN. Well, that was our original recommendation, that they introduce a carbon tax, working in tandem with a gasoline tax. But, because this is designed to add the extra surcharge on oil and to exempt emerging renewable sources, it is the best type of BTU tax and certainly will accomplish some of the same goals that we are looking for.

Senator PACKWOOD. What would you recommend we should do with the exemption, preference, call it what you want in this, given to high-sulphur coal?

Ms. GRIFFIN. In what way do you mean?

Senator PACKWOOD. In order to not make this a tremendous hit on coal, and mainly eastern coal, we have given a preference in this. It is just like we have hit hydro hard, even though, on a BTU basis, we would not hit it as hard. But, for a variety of reasons, you call it equity in others we did. At the same time, on high-sulphur coal, if it was to be hit hard, in Senator Rockefeller's State and half a dozen States would be disproportionately adversely affected. I am curious if you like the way it has been treated in this bill.

Ms. GRIFFIN. Yes, as far as it being taxed at the straight rate. I think that is appropriate. I think it is appropriate that our oil tax be higher.

Senator PACKWOOD. I am not talking about oil. Coal.

Ms. GRIFFIN. Right. I think it is appropriate that our oil tax be higher and I think that a high enough coal rate is also appropriate.

Senator BAUCUS. Thank you. Senator Rockefeller.

Senator ROCKEFELLER. No further questions.

Senator BAUCUS. Thank you all very much. I appreciate your testimony.

Ms. GRIFFIN. Thank you.

Senator BAUCUS. Our next panel consists of Paul Fry, deputy executive director of the American Public Power Association; William Drummond, manager of the Public Power Council, from Portland; The Honorable Dennis—is it Nagel, Nagel?

Mr. NAGEL. Nagel.

Senator BAUCUS. Nagel, president, National Association of Regulatory Utility Commissioners, and chairperson of the Iowa Utilities Board from Des Moines; Mr. A.W. Dahlberg, president and chief ex-

ecutive officer of Georgia Power Company from Atlanta, on behalf of Edison Electric Institute; and Ellen S. Roy, vice president of Intercontinental Energy Corporation from Boston, on behalf of National Independent Energy Producers.

Where is Mr. Fry? [Pause]
 Senator BAUCUS. Thank you.
 Mr. Fry.

**STATEMENT OF PAUL R. FRY, DEPUTY EXECUTIVE DIRECTOR,
 AMERICAN PUBLIC POWER ASSOCIATION, WASHINGTON, DC**

Mr. FRY. Mr. Chairman, members of the committee, I am Paul Fry, deputy executive director of the American Public Power Association. APPA is a national service organization representing more than 1,750 municipal and other local publicly-owned electric utility systems. These utilities serve 15 percent of the Nation's electric consumers, or approximately 35 million Americans. They are located in 49 of the 50 States, in Guam, the Virgin Islands, and Puerto Rico.

APPA has a history of opposition to energy taxes, and this opposition has been based on concerns about the inequitable regional distribution of the burden of such taxes, the difficulty of ensuring fair and efficient administration, the potential adverse effects on international competitiveness, and the fact that an energy tax is inherently regressive.

Despite this history, there is a broad consensus of our membership that the Federal budget deficit is a serious issue which must be addressed. The proposed BTU tax is part of a proposal to deal with this issue. Accordingly, our organization has suspended its policy of categorical opposition to energy taxes and is determined to work with others to perfect the administration proposal so that it is best formed to achieve its goals in a fair and efficient manner.

In general, APPA believes that an energy tax should treat different fuels, regions, customer classes, and electric utility industry sectors equitably, and should be structured with an eye to fair and efficient administration. Additionally, tax revenues should be used for the purpose of deficit reduction and the tax should contain a sunset provision.

Since energy taxes are regressive, steps should be taken to mitigate this effect. APPA members believe strongly that BTU tax revenues should be applied to the goal of deficit reduction. This shared goal is the paramount reason APPA suspended its traditional opposition to an energy tax.

If the administration's economic program is successful, it could mean lower long-run costs for all consumers. For example, Treasury Secretary Bentsen has argued that, for every one-tenth of a percentage point that long-term bond yields decline, companies and individuals save \$10 billion of interest payments.

Furthermore, we believe that the tax should not be perpetual. Rather, it should have a sunset feature that cancels the BTU tax automatically and coincidentally with the end of the administration's economic package. This feature would trigger a mandatory review of the merits of the tax and its contributions to the goal of deficit reduction.

APPA's position with respect to the collection points for the tax is driven by concern for fair and efficient administration. If collecting the tax upstream near the point of production means fewer taxpayers, and, consequently, less costly, surer administration, then that is the structure we would prefer. We suggest merely that pass-through of the tax be neither prohibited nor limited in any way, including the right to itemize the tax on customer bills.

We endorse the administration's position that there be no exemptions from the tax based on the character of the purchaser. This makes it clear that Federal facilities, for example, will be responsible for their fair share of the tax as applied to their electricity bills.

On the important issue of fairness, we believe more information is needed. There is a willingness to accept shared sacrifice in order to deal with the problem of deficit reduction, but the sacrifice must be distributed equitably. Our membership would like to see a detailed, verifiable analysis of who will bear the burden of the proposed tax. Such information is essential for the evaluation of perceived inequities and the modifications proposed for their remedy. We do not believe that the information released to date is adequate for this purpose.

Thank you.

Senator BAUCUS. Well, that was nice and brief. Thank you very much, sir.

[The prepared statement of Mr. Fry appears in the appendix.]

Senator BAUCUS. Next witness is—

Senator PACKWOOD. I would like to introduce, if I might, Mr. Drummond.

Senator BAUCUS. Yes. Yes.

Senator PACKWOOD. Mr. Chairman, I would like to introduce Mr. William Drummond, who is a distinguished witness from my State of Oregon. He is the manager of the Public Power Council, which is an association of publicly- and consumer-owned utilities in the Pacific Northwest.

He has been with the PPC since 1985. He started, first, as a staff economist and became manager in 1988. He is here today to discuss the effects of the proposed energy tax on consumers of hydroelectric energy. He has considerable knowledge and expertise in this area, and I welcome his comments.

Senator BAUCUS. Thank you.

Mr. DRUMMOND. Thank you, Senator.

Senator BAUCUS. All right. Mr. Drummond.

STATEMENT OF WILLIAM K. DRUMMOND, MANAGER, PUBLIC POWER COUNCIL, PORTLAND, OR

Mr. DRUMMOND. Thank you. Mr. Chairman, members of the committee, as the Senator has pointed out, I am William Drummond, of the Public Power Council. We represent about 115 publicly and cooperatively owned electric utilities in the northwest.

Because of the inherent inflationary and regressive nature of energy taxes, the Public Power Council has long opposed the adoption of any form of an energy tax. We applaud the administration for taking significant steps to mitigate the regressivity of the proposed

tax and for exempting from taxation energy conservation and non-conventional fuels.

Nonetheless, the Public Power Council continues to oppose the energy tax in its current form due to the excessive tax burden that would be placed on consumers of hydroelectric energy. The Public Power Council believes that the administration's proposed energy tax applies a scientifically invalid heat rate to hydropower that results in an excessive taxation of this energy source. Correction of this portion of the energy tax would not violate regional equity, nor significantly reduce the revenue generated by this tax. In contrast, failure to assign scientifically correct BTU value to hydropower will result in significant regional economic dislocation and discourage the use of an important renewable resource.

We have three main objections to the tax in its current form as it is applied to hydropower. First, as I mentioned, hydropower is taxed at an artificially high rate. As the members of the committee are aware, the administration's energy tax is purported to tax each fuel based upon its heat content, as expressed in BTUs, or British Thermal Units. However, under the tax plan, hydropower is taxed at nearly three times its actual BTU equivalency.

Under the administration's proposal, the tax on hydropower is based upon the BTU input of an average fossil fuel plant rather than the actual BTU value of a kilowatt hour of electricity generated from falling water.

The BTU rating in the administration's proposal is 10,315 BTUs per kilowatt hour. The correct number is 3,754 BTUs. The higher BTU number incorrectly assumes that converting falling water to electricity is as inefficient as generating electricity with fossil fuel. This incorrect assumption results in nearly a tripling of the tax rate applied to hydropower.

Second, we believe that the energy tax could cripple the northwest economy. While the Pacific Northwest is historically characterized as having low electric rates, these rates are rising steadily. The estimate for the pending Bonneville Power Administration rate case has recently been revised upward to at least a 15 percent increase. Resource acquisitions, Endangered Species Act compliance, and sustained drought are likely to result in additional rate increases of 20 percent over the next few years.

The administration's Power Marketing Administration Repayment Initiative, if adopted, would add a four percent rate increase. If unadjusted, the energy tax would add an additional 12 percent to current BPA rates. Combined, the region could face a 50 percent increase in the cost of Bonneville Power within 3 years.

While the administration's energy tax is clearly designed to revenue or deficit reduction, this is not an end in itself. Rather, it is a means of achieving the goal of long-term economic growth and fiscal health. If the over-arching purpose of the plan is the restoration and maintenance of a strong economy, then it must be recognized that economic conditions in the Pacific Northwest are extremely fragile and unlikely to sustain the impact of a proposed energy tax as currently calculated.

Sixty percent of Bonneville's energy sales go to industrial customers. Given the energy-intensive nature of the northwest economy, correcting the conversion factor for hydropower would provide

much-needed economic relief. This relief could be provided without dramatically decreasing the total revenue generated by the energy tax. According to our calculations, the reduction in tax receipts would be approximately \$500 million per year once the tax is fully phased in.

Finally, the hydropower tax causes regional inequity. Administration officials concede that the imputed BTU value for hydropower is not scientifically justified. They suggest that the high energy tax rate was necessary to create equity in the impact of the energy tax on different regions of the country. While this goal is understandable, in fact, the excessive hydropower tax appears to impose a disproportionate burden on the Pacific Northwest.

According to a preliminary analysis of the tax based upon Department of Energy data, the per capita increase in Montana would be 30 percent higher than the national average; in Washington, the impact is 20 percent above the national average; Idaho would be 5 percent above the average; and Oregon residents would be at about the national average.

According to an analysis by the Washington State Energy Office, taxpayers in that State would still pay more than the national average, even if the hydropower tax were correctly calculated, only to climb at long driving distances and energy-intensive industries.

Some will point to the lower electric rates in the northwest and question how the tax on hydropower can be reduced without violating regional equity. It must be understood that the higher-than-average tax burden to the region results primarily from the petroleum surcharge, due to long driving distances.

According to the Department of Energy data, tax on oil will comprise 52-64 percent of the total energy burden within the States in the region. The Public Power Council urges Congress to tax hydropower at its actual equivalent value of 3,754 BTUs. Making this adjustment will ensure scientific consistency, regional equity, and economic vitality.

Thank you, and I would be happy to answer any questions.

Senator BAUCUS. Thank you, Mr. Drummond.

[The prepared statement of Mr. Drummond appears in the appendix.]

Senator BAUCUS. Next, Hon. Dennis J. Nagel.

Senator GRASSLEY. Mr. Chairman.

Senator BAUCUS. Yes.

Senator GRASSLEY. He is a constituent of mine. Could I say something about him?

Senator BAUCUS. Absolutely.

Senator GRASSLEY. Well, first of all, he is the first Iowan that has held the position of president of the National Association of Regulatory Commissioners, so I want to compliment him for that leadership. He has been on our utility regulation board, I think, about 5 years, if I am right, roughly.

He previously has been aides to two Governors in two different States. One, Governor Ahill, in New Jersey, and then I first met him when he came on the staff where he served Governor Ray, of Iowa, for about seven or 8 years. I think he started to work for Governor Ray about the time I left the State Legislature.

So, I am very proud to have Mr. Nagel here with us. Most importantly, very proud to have him in a position of leadership, as he is with the National Association.

STATEMENT OF DENNIS J. NAGEL, PRESIDENT, NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSIONERS, AND CHAIRPERSON, IOWA UTILITIES BOARD, DES MOINES, IA

Mr. NAGEL. Thank you, Mr. Chairman, and members of the committee. Good morning. This morning I testify on behalf of the National Association of Regulatory Utility Commissioners. We greatly appreciate the opportunity to present our views on the subject of the proposed energy tax.

The NARUC has been an active participant in the debate over the administration's modified BTU tax since shortly after President Clinton announced his original tax proposal in February. While NARUC remains neutral on the issue of the energy tax, our resolution states six items we believe must be addressed in the design of any broad-based energy tax.

I want to devote my time this morning to address the Treasury's proposal on the passthrough issue, and also discuss the major issue of energy efficiency, as affected by the tax proposal.

NARUC is supportive of one of the key objectives of the modified BTU tax, which is to send price signals to energy consumers: conserve energy. We are willing to work with the administration, the Congress, and other interested parties in seeing that this objective is achieved.

At the same time, the NARUC is committed to its twin principles of seeing that Federal preemption of State regulation is an action of absolute last resort and should be undertaken only when fully justified, and that State Commissions, because of their proximity to the people we regulate, are best able to determine the justness and reasonableness of utility rates.

The Treasury Department's April 1 proposal on the passthrough issue would deny certain tax benefits to utilities for periods during which the energy tax is not completely passed through to end users. Withholding the benefits of normalization from a utility for the time period that the BTU tax is not passed through would unnecessarily extend the reach of the normalization provisions into another area of State ratemaking authority. It also runs counter to the original Congressional intent of normalization, which is to slow the flow-through of utility tax benefits to ratepayers.

I would submit that there already exists a time-tested and effective means of passing through the cost of the energy tax, and that is State Commission rate-setting mechanisms.

Most State Commissions have a mechanism for dealing with fuel cost increases that would occur as a result of the modified BTU tax. These mechanisms are generally known as energy cost adjustments and are commonly referred to as Fuel Adjustment Clauses, or FACs, in the electric utility industry, and Purchased Gas Adjustments, or PGAs, in the gas utility industry. The tables accompanying my written testimony indicate that three-quarters of the States have FACs in place, and 47 States use PGAs.

In States without these mechanisms, or when the BTU tax is imposed directly on hydro- or nuclear-generated electricity, a utility

may file for a rate increase. These increases typically go into effect in short order, subject to suspension by the State Commission. Both rate mechanisms—the energy cost adjustments and rate filings—provide ample opportunities for utilities to recover their increased costs due to the tax.

There also is no evidence to support the claim that a State Commission might withhold any portion of the Federal tax paid by a utility. In fact, we can find no incident where a State Commission has taken such action against a utility. State Commissions are obliged by the Constitution to include all reasonable costs of providing utility service and rates, and bona fide taxes imposed by the Congress have always been viewed as reasonable costs.

Besides calling for no preemption of State ratemaking authority in the design of the energy tax, the NARUC believes that such a tax should be designed to encourage energy efficiency and optimal use of fuels.

We do not believe there is sufficient evidence to prove that energy efficiency would be substantially improved if there is a mandatory requirement that utility ratepayers bear the full cost of the BTU tax.

Guaranteeing 100 percent passthrough does not, in our opinion, guarantee substantially more energy savings or energy efficiency improvements. What it does is actually remove incentives for utilities to make their energy production, transmission, and distribution operations more efficient. These costs and these efforts encompass the optimal use of fuels used in the generation of electricity.

Congress, in passing the Energy Policy Act of 1992, expressly required the State Commissions to consider regulatory incentives that would allow electric utilities to improve their supply side efficiency. NARUC supported enactment of this provision.

Ensuring that the tax is borne only by entities on the demand side of the utility meter runs counter to the policy adopted just last year by this Congress. Therefore, we believe that any energy tax should be designed to encourage efficiency on the supply side, as well as the demand side of the meter.

Let me conclude, Mr. Chairman, by telling you that the NARUC is willing to work with this committee, the Congress, and the administration, in determining what energy tax is in the best interest of our country.

Thank you very much.

Senator BAUCUS. Thank you, Mr. Nagel.

[The prepared statement of Mr. Nagel appears in the appendix.]

Senator BAUCUS. Mr. Dahlberg.

STATEMENT OF A.W. DAHLBERG, PRESIDENT AND CHIEF EXECUTIVE OFFICER, GEORGIA POWER COMPANY, ATLANTA, GA, ON BEHALF OF EDISON ELECTRIC INSTITUTE

Mr. DAHLBERG. Thank you, Mr. Chairman. My name is Bill Dahlberg, and I am president and CEO of Georgia Power Company. Georgia Power Company is the largest subsidiary of the Southern Company, a large utility holding company. Georgia Power Company serves about 1.6 million customers in one of our Nation's fastest-growing States.

I appreciate the opportunity to appear before the committee this morning, and I am representing this morning the Edison Electric Institute, the association for investor-owned utilities, to present our views on the administration's proposed BTU energy tax.

EEl supports the efforts of the President and the Congress to reduce the Federal budget deficit and to promote further economic recovery. We believe that most of our customers and most Americans want to see the budget tamed primarily through cuts in Federal spending, and then, if necessary, through fair increases in taxes. Thus, it is not surprising to learn that in a recent Wall Street Journal NBC News poll, it found that only 35 percent of Americans support the energy tax, while 62 percent oppose it.

Over the last several months, EEl has analyzed the impact of the administration's proposed BTU tax on our companies, on our customers, and on our National economy. As a result, we believe that if Congress, (1) recognizes the direct impact this tax would have on low- and moderate-income families, and (2) considers the effect of the BTU tax on the competitiveness of American industry, then Congress, like EEl, will reject this form of taxation.

Low cost and reliable energy is a fundamental ingredient in economic well-being. The proposed BTU tax will have an alarming ripple effect throughout the economy as the costs of all products and all services increase. This ripple effect at home will create waves for American manufacturers seeking to do business overseas.

Large industrial consumers of electricity will be significantly affected. In Georgia, for example, our industrial customers will pay an additional \$166.9 million. That represents an increase of six to 7 percent in the energy cost for these industrial customers.

In some regions of the country, the increase in the cost of electricity will exceed 10 percent for industrial customers. With the administration's additional tax, some of our most valuable industries—autos, airlines, primary metals, aluminum, chemical manufacturing, paper, and agriculture—will be put in a less competitive position at home, and, more importantly, abroad.

You have heard others assert that American energy costs are too low in comparison to other developed nations. I want to tell you that that is not a problem. To the extent that our energy costs are low, it gives us a competitive advantage and we should be striving to protect, not destroy, that competitive advantage.

It is also interesting to note that our trading partners have largely rejected broad-based energy taxes, and, in some instances, subsidize the energy sector. Ironically, the proposed BTU energy tax will act as a subsidy for foreign imports since those goods will be exempt from this tax.

The importance of international competitiveness to the American economy cannot be overstated. In 1992, growth in U.S. exports account for one-third of this Nation's 2.1 percent growth of GDP. Thus, it makes little sense to penalize the sector of the economy that continues to lead us out of the economic doldrums. Beyond this obvious macro-economic effect, the BTU tax would have a significant and direct impact on the average American family.

Americans have been told that the energy tax will add only a few dollars a month to their home utility bills, and a few dollars a month more at the gasoline pump. Presented that way, the energy

tax doesn't sound too bad. And, for those below the poverty level, or marginally above it, we are assured that there will be tax rebates and income credits.

What the public may not understand is that, in reality, we will all be paying for the energy tax. Everything that America buys, if it is made in America, will carry a hidden price tag that includes the energy taxes paid by the manufacturer, by the manufacturer's suppliers, and the distribution network, including transportation and additional retail costs.

Consumers are going to pay this tax whenever they buy food, clothing, shelter, or any product or service that has an imbedded energy cost. In fact, the Treasury Department estimates that a family of four earning \$40,000 a year will see its cost of living rise \$440 a year because of the total burden of the BTU tax. This represents about a 15 percent increase in the Federal tax burden that such a family faces as a result of Federal income taxes.

As proposed, the BTU would be compounded by State and local piggyback taxes. An increase in fuel costs caused by the BTU tax will automatically increase State and local taxes on gross receipts, franchise fees, sales taxes, and other utility taxes. In some cases, these piggyback taxes amount to up to 16 percent.

We hope that the committee will explore carefully whether an inherently regressive BTU tax will have the deficit fighting punch that its backers might hope. The administration's budget contains billions of dollars of additional spending for Earned Income Credit, Food Stamps, and Total Energy Assistance.

To a large degree, the additional spending is required to simply reduce the regressive impact of the BTU tax itself. We believe that the remaining possible benefits of the tax will be lost, or a BTU energy tax will reduce economic growth, cost the economy jobs, and increase inflation.

A recent data resources analysis—

Senator BAUCUS. I am going to have to ask you to summarize, Mr. Dahlberg, as best you can.

Senator ROCKEFELLER. Yes. I was going to suggest the same myself.

Mr. DAHLBERG. Let me make just one concluding statement then.

Our concern, really, is two-fold. It is the impact on all of our consumers, but our principal impact is on the industries of this country. We think it does put us at an international competitive disadvantage. Some studies show that it could cause us to lose as many as 600,000 jobs. I do not know how many, but I do know it will have an impact on our competitive position and we should not let that occur.

Thank you, Mr. Chairman.

Senator BAUCUS. Thank you, Mr. Dahlberg.

[The prepared statement of Mr. Dahlberg appears in the appendix.]

Senator BAUCUS. Ms. Roy.

STATEMENT OF ELLEN S. ROY, VICE PRESIDENT, INTERCONTINENTAL ENERGY CORPORATION, BOSTON, MA, ON BEHALF OF NATIONAL INDEPENDENT ENERGY PRODUCERS

Ms. ROY. Thank you. Mr. Chairman, my name is Ellen Roy. I am vice president and director of Intercontinental Energy Corporation, and the Chairperson of the Energy Tax Committee of the National Independent Energy Producers. I thank you for allowing me to testify here today.

I am here to talk about three things. One, is to tell you a little bit about the independent power industry and what we do; second, is to explain how the design of the energy tax can be improved to better serve the goals of conservation and efficient revenue collection without putting an unfair burden on the ability of the independent power industry to compete; and third, is to show why pass-through of energy taxes for future, as well as existing IPP projects, is critical to the development of competition in the power industry—a goal that Congress recently reaffirmed when it passed the National Energy Policy Act in 1992.

Intercontinental Energy Corporation is an independent power producer, or IPP, as we say, with co-generation facilities in Massachusetts, New Jersey, and Pennsylvania. The National Independent Energy Producers, or NIEP, as we also say, is an association of companies like ours that generate electricity for sale to utilities, and steam for sale to industry. Our members use highly reliable fossil fuels and renewable technologies, including hydro, pump storage, geothermal, biomass, wood, and waste energy, as well as traditional natural gas, oil, and coal.

Our companies' facilities, most of which were built in the 1980's, are highly efficient and use state-of-the-art, environmentally advanced technologies. Our companies typically sell power wholesale to electric utilities on the basis of long-term contracts. In 1989, the independent power industry has supplied over 50 percent of all new electric capacity brought on-line in the United States.

The key to a fair and efficient energy tax is its collection point. In the administration's February proposal for upstream collection of the tax, the seller of gas, coal, or oil would collect the tax at the point of sale prior to the fuel being used to produce electricity.

NIEP has expressed concern about this to the administration, that a tax in this form would have the unintended consequence of damaging the independent power industry. IPPs are not like regulated utilities which can pass on, in most cases, costs to ratepayers. Instead, IPPs sell electricity to utilities under long-term contracts that typically do not permit the seller to passthrough the energy tax.

The unintended consequence is this: if IPPs have to pay all or some significant portion of the tax with no way to pass it along, the tax could well jeopardize our ability to repay our bank loans, or even to keep operating.

An equally important effect of this tax in the way it is currently designed is its impact on competition in the electric power markets. Wholesale generators of electricity, such as IPPs, compete with traditional cost-of-service plants for the right to build new electric capacity.

If IPPs with long-term contracts are placed at a disadvantage relative to their utility competitors by virtue of the IPPs inability to passthrough the tax to the ultimate consumer, competition will be tilted in favor of the utilities, depriving consumers of many of the benefits of competition.

To better meet the administration's goals, NIEP recommends the following alternative to an upstream energy tax. The energy tax should be imposed downstream at the retail burner tip for natural gas, or at the retail electric meter. This collection point would eliminate the passthrough problems for utilities and IPPs, alike.

NIEP believes that this approach to the energy tax better serves national policy objectives. For example, the goal of revenue collection is met; the goal of conservation is enhanced; and the goal of administrative ease is also furthered.

NIEP is pleased that the administration, in its April revisions to the proposed energy tax, has responded to some of our concerns by providing a special rule designed to ensure that independent power producers would not be competitively disadvantaged. While this approach is less efficient than a downstream retail tax, it is a big improvement over Treasury's original proposal in February.

To further improve the design of the tax, NIEP recommends additional modifications with respect to definitions, deferral versus credit mechanisms, and the perspective application of the tax.

I would like to emphasize this last point. To avoid undermining the purpose of the Public Utility Regulatory Policy Act, as well as the 1992 National Energy Policy Act and the competitive position of the independent power industry by giving utilities another bargaining chip over IPPs, the energy tax credit deferral mechanisms for IPPs should apply prospectively, as well as to existing contracts.

Thank you for your time, and we look forward to working with you on this problem.

Senator BAUCUS. Thank you, Ms. Roy.

[The prepared statement of Ms. Roy appears in the appendix.]

Senator BAUCUS. Ms. Roy and Mr. Dahlberg—if you want to join in, Mr. Drummond, that is fine, too—you have heard the earlier panel testifying that the collection points should be further upstream, forcing utilities to make better environmental choices, as opposed to the collection point for the downstream, as you suggest, a burner tip, for example. What about their argument that it is further upstream that forces utilities to make better environmental choices, in selection of fuels, for example.

Ms. ROY. I have two responses to that. First of all, as the witness alluded to, there are practical problems to that, which are our long-term contracts and other mechanisms which prevent the consumer from ever seeing that tax. In our case, in our industry, if you put the tax upstream, we will absorb 100 percent of that tax, and, yet, we have no ability to change our behavior in response to that tax, or in response to that price signal.

So, there are areas in the economy which, if you put it all the way upstream, in fact, that company will absorb 100 percent of it and the consumer will never see the price signal in which to provide for changes in their behavior, and no conservation goals will be met.

The second point that I would make is that we are profit-motivated and if we have \$100 that we are spending on fuel today and the energy tax will make it \$110 or \$120, we still have a large incentive because of that \$100 we are already spending on fuel to come up with a more efficient way of organizing our electricity production.

Senator BAUCUS. Mr. Dahlberg.

Mr. DAHLBERG. Senator, I really think, in the long-term, all costs of doing business are going to be reflected in consumer prices. It gives the consumer the opportunity to evaluate that price against others, whether that is an import or a competitor. I think we need to give the consumer the opportunity to make those choices. Sooner or later, I think that is the point it should be, whether you enact this and place it at one point. Sooner or later, it will be reflected, I believe, in the price of the product, and that is where it properly should be.

Senator BAUCUS. Mr. Nagel, in trying to evaluate what to pass-through and what not, and trying to assess the environmental impacts of utilities' options, will PUCs essentially say, in assessing, say, Georgia Power's request for the passthrough of this BTU tax, that, oh, no, Georgia Power, you have got to change your fuels a little bit here and you have got to be more environmentally sensitive, to what degree will Commissioners make that assessment?

Mr. NAGEL. Not in the direct sense that you just indicated.

Senator BAUCUS. I am sorry?

Mr. NAGEL. Not in the direct sense that you just indicated. It is in a longer term consequence that that issue would arise. As I mentioned, the Constitution basically requires if you incur reasonable costs, then we cannot disallow that reasonable cost in the regulatory process, and certainly a Federal tax would be deemed to be a reasonable cost. That issue would arise in a longer term consequence, looking at the mix that a utility puts together to procure its resources. Then if a public utility commission would deem that there was a better mix available, a lower cost mix available to serve the customers, there might be some disallowances involved. But the direct Federal tax itself would not be a trigger for disallowance.

Mr. DAHLBERG. Senator, I might add one thing. We have just gone through a great debate over the last couple of years that resulted in the enactment of a new national energy policy. One of the requirements in that law is the filing of an integrated resource plan so that commissions have the opportunity to review the total concept of the utilities' plans and can look at the economic mix. I think that is the proper way to look at these things. Additional fuel costs would be one element in that plan, and we do have Federal legislation now that provides that mechanism.

Senator BAUCUS. You know, there are a lot of people who say that this country must do a better job in pursuing sustainable development. That is, countries like Japan consume about half the energy we consume per same unit output, and consume half the natural resources that we consume versus the same unit output; the argument being that, therefore, they are much more efficient in their production and manufacturing process, and, therefore, are much more competitive in world markets. Further, that there is

less of environmental damage because there is less energy consumption. Most energy consumption does have an environmental consequence. I am just curious what your reaction is to all that. To go further, I am very impressed with some organizations—one person in particular I met down at the Rio Summit, is putting together large business organizations, CEOs of major companies worldwide—who are very much pursuing life cycle planning of sustainable development, not for better environmental objectives, but to prove their bottom line. I am curious what your reaction is to that.

Mr. DAHLBERG. I guess my reaction is—again, I do not want to push it off on another piece of legislation—that we have gone through a period of time when we have looked at environmental policy, and we did enact the amendments to the Clean Air Act just 2 years ago, and we responded to that. Last year, in the National Energy Act that was passed, again, there are provisions for reviewing utility plans.

I would suggest, if you look at the improvements and efficiencies in electric utilities over the last few years, you would see sizeable improvements in the use of energy for the production of power. If you go to an American manufacturer today, I think you will see improvements in the efficiency of that production.

Senator BAUCUS. Your argument is that we need more incentives in this country to push us further in this direction.

Mr. DAHLBERG. I think that is correct. Yes, sir.

Senator BAUCUS. You do think we do?

Mr. DAHLBERG. Yes, sir.

Senator BAUCUS. Is that not one of the arguments behind the BTU tax, to help achieve that goal?

Mr. DAHLBERG. Well, I think one of the counter problems, though, is that if you impose this tax on energy, those industries that are energy-intensive, those that have to compete with foreign products, are really going to be put at a competitive disadvantage. So, you might push it in that direction. You have to be concerned about aluminum producers, or primary metals, or papers.

Senator BAUCUS. Thank you.

Mr. DAHLBERG. There are no provisions offset at the border.

Senator BAUCUS. Thank you. Senator Packwood.

Senator PACKWOOD. Max, you mentioned Japan. It is interesting, on this subject of aluminum. Japan is energy short. I will first use the analogy of the apparel industry and then move to aluminum. Twenty years ago, Japan was in the top 10 in the world on the export of both apparel and textiles, both the cloth and the cloak. They decided they could not compete in the wage industry in apparel; it was still heavily a hand industry. They basically got out of the export of apparel. Today they are not in the top, probably, 25. I have not seen figures below that. They are still successful in the export of textiles, which is heavily capital intensive, and you can do well.

They made the same decision on aluminum. Twenty-five years ago, Japan used to be a large aluminum smelter, but energy was too expensive. They did not have enough energy, and they got out of it. They just said, this is an industry we cannot afford to justify, based upon the energy content it takes. I fear that is what is going to happen to Montana and Oregon.

Senator BAUCUS. The same with the coal mines, too. They shut down their very inefficient coal mines.

Senator PACKWOOD. Yes. They could not do it. And I think that is a lesson we ought to keep in mind as we start to increase and increase the cost of our production for the aluminum industry. They can well go someplace else, and they may decide to do that.

Mr. DAHLBERG. Senator, I share that exact same concern. Aluminum is probably the most energy-intensive. But we have a wire manufacturer in Carrollton, Georgia and they have exactly the same difficulty. This tax will increase their energy costs by about 8 percent.

Senator PACKWOOD. Yes.

Mr. DAHLBERG. When I am looking for wire suppliers, I am going to evaluate their costs versus the imports that we see, and we do see imports. And that 8 percent is something that they cannot offset. So, I have the exact same concern that you do. While they can compete successfully now, if a tax is imposed on them that is not imposed on foreign importers, then that is going to be a problem. They also have an export market, and they are going to lose some of that market as well.

Senator PACKWOOD. I am fascinated by those who say, well, this only increases business' cost four percent, as if four percent is nothing. Four percent is the difference in many businesses, in terms of competition.

Mr. DAHLBERG. I agree with you.

Senator PACKWOOD. Mr. Drummond, let me ask you a question. Administration indicates that the impact of the tax on the west coast States of California, Oregon, and Washington will be slightly below the national average, and yet you suggest that, in the northwest, it is going to be 20 percent more than the national average. Why is that, is California lumped into that, and because they are so heavy it weights the average?

Mr. DRUMMOND. California completely swamps any analysis that you do of impacts in the northwest. The analysis that I referred to was done on the States of Idaho, Oregon, Washington, and Montana.

Senator PACKWOOD. And, in that case, we are going to get stuck pretty heavily.

Mr. DRUMMOND. That is correct. And, as I mentioned, again, even changing the hydro tax, as we suggest, it is lost because of the great driving distances we face in the west.

Senator PACKWOOD. Thank you, Mr. Chairman.

Senator BAUCUS. Thank you. Senator Rockefeller.

Senator ROCKEFELLER. Thank you, Mr. Chairman. Mr. Dahlberg, I am going to try to put this as tactfully as I can. I have worked very carefully with Edison Electric Institute on the Staggers Act. I think that we caused, through legislation that did not pass, in fact, a change to be made on the Interstate Commerce Commission, which made your life a lot easier.

But I have to say that listening to your testimony is like testimony I used to hear when I first came up to the Congress about 6, 7, 8 years ago: all one-sided, just protect your own interest at any cost, that what happens to the Nation makes no difference whatsoever. The Federal budget deficit does not seem to make any

difference whatsoever. I mean, you made a series of statements that are amazing to me. You started out by saying—as everybody who is about to savage a particular proposal does—we believe very strongly in budget deficit reduction. And then you say, well, we should just do it by budget cuts, and then taxes if we have to.

I think one of the things that is clear is that the President has made the most major effort in deficit reduction of the last 20 years, \$1.5 trillion. And what you are basically saying is that you cannot live with that, that we are going to be nationally uncompetitive. My understanding, generally, of utilities is that utilities can make more money, or less money, depending upon what public service commissions do to them. But it is not very often a utility loses money.

I am interested in what your response is in terms of the effect of the budget deficit itself on international competitiveness of American industries.

Mr. DAHLBERG. Senator, I am sorry I did not give you the proper impression. I do wish the President all the success in the world, and the Congress all the success in the world. I do treat the deficit as a severe problem. I do not want to make that problem worse.

Senator ROCKEFELLER. Could you answer my question, please?

Mr. DAHLBERG. Yes, sir. My concern is that our analysis of this tax—

Senator ROCKEFELLER. No, no. My question was, could you give me your impression of the effect of the current budget deficit and the direction that it is going, of the interest payment on the national debt, the cost of all of that on our international competitiveness, which is the reason that you gave for being against this particular tax, and virtually any energy taxes.

Mr. DAHLBERG. Yes, sir. I do not have an analysis of it. But there is no question—

Senator ROCKEFELLER. But you are a businessman. You have been in this. You can talk to me about it.

Mr. DAHLBERG. There is no question that the deficit has a negative effect on our business and on our competitiveness. My concern is that we make that problem worse. And our concern is, if we do the analysis, once you apply the tax and you look at the effects on specific industries, that, in effect, it will take more out of the economy than it will gain, and, in effect, the deficit would not be reduced.

Senator ROCKEFELLER. And you are saying that the way that this tax would affect utilities which are basically held-harmless in terms of losing money in relation to most other businesses in this country—you are going to have some people in the next panel from steel and aluminum complaining about massive job loss directly. But you do not lose jobs.

Mr. DAHLBERG. No, sir.

Senator ROCKEFELLER. You talk about worrying about the cost to your customers. But are you saying that the cost of this to your utility or to the utilities in general in this country is going to be a greater threat to national competitiveness than our current course on the budget deficit?

Mr. DAHLBERG. No, sir. My testimony supports, I think, what you will hear later. I am not commenting principally on the utilities

themselves, in the short-term. I think, certainly, if we lose manufacturing base and we lose manufacturing jobs, that, in the long-term, yes, it will hurt us, because that is a customer gone. If we have a manufacturer that cannot compete or is put at a competitive disadvantage and they reduce production, yes, it causes a reduction for the utilities. My concern is the impact on all of American industry.

Senator ROCKEFELLER. Well, I understand what you are saying very, very well.

Let me just say that I hope that, in conversation with Senators and Representatives, as you, yourself, do this, that you will be far more effective if you do not use the so-called slash and burn tactics that were used four or 5 years ago by industries and others who came in who generally took the point of view, if you do this, the world is going to come to an end, we are not going to be able to compete. Everything comes to a dead halt. We have grown a lot more sophisticated around here now.

I come from a State that—Mr. Drummond was complaining about the fragile Oregon economy, and his unemployment rate is 7.3 percent, which is just slightly above the national average. In West Virginia, we count ourselves lucky if we are below 11 percent.

My suggestion is that recently around here there are a lot of us—including those of us who come from energy States—who recognize that the budget deficit is our greatest problem. And we all are coming to the point where we are beginning to adjust our thinking to think more moderately, more persuasively, frankly, more intelligently, in how we solve our Nation's problems. And we do that by reflecting in the way we talk that we are not all going to get everything we want out of this, that we are all going to have to make some kind of a sacrifice, and we are going to have to do that in order for the country to survive. And that is true whether you are talking about health care—do I wish the President would pick something other than an energy tax? Of course I wish he would pick something other than an energy tax; I come from an energy-producing State. But he has picked an energy tax, and we have worked to try to modify it in certain ways, and it has been done. And I am going to live with it, and I am going to support it, because that is my contribution, as a Senator, towards the reduction of the national deficit, and, therefore, our international competitiveness.

I guess I would just—and I have run over my time, Mr. Chairman—sort of think about updating the way you approach testimony in talking with people. We think a lot differently around here than we did four or 5 years ago.

Thank you, Mr. Chairman.

Senator BAUCUS. Thank you, Senator. Senator Grassy.

Senator GRASSLEY. Thank you. Mr. Nagel, once again, thank you for your leadership, and thank you for coming to testify. I know you are testifying for your association, and I guess I would invite either association or your own personal point of view, as you might want to identify. Some argue that since some States have automatic passthroughs, other States are going to be unfairly impacted. Would an automatic passthrough on the BTU tax be justified, or should it be left up to the individual States?

Mr. NAGEL. As I tried to explain in my testimony, Senator Grassley, the great majority of States have provisions which, without having an additional hearing or delay, should accommodate those utilities that will experience this tax.

In Iowa, for example, we have both a PGA for the gas utilities, and an Energy Adjustment Clause for the electric utilities. This tax, because of the component of the fuel tax, the cost of fuel will be passed on to the customers through those adjustment clauses automatically. So, certainly, the utilities in our State will not face any problems recovering the costs there.

And, in the few States that do not have these automatic adjustment clauses, the normal rate case mechanism is available for addressing this concern, and certainly the last thing I think we need to keep in mind is that the tax component is simply one element of the overall set of costs that a utility will incur in providing utility service. And, while one element may be going up, other elements may be going down, and a certain utility in a State that does not have an automatic adjustment clause will have to consider, is this the best time for us to come in for a rate case?

Senator GRASSLEY. Also, Mr. Nagel, if this tax would be imposed, how would you feel about limiting the ability of certain customers to avoid the tax by either bypassing utility systems or installing their own electric generation, or should such attempts at bypass be subject to the tax anyway?

Mr. NAGEL. One of the consequences of the automatic adjustment clauses that I mentioned is that this tax be treated as if it were simply the additional increment of the cost of fuel. And because fuel costs are typically passed on to customers on a per-unit basis of fuel consumed, that means it falls disproportionately on certain customers. Primarily, that means industrial customers. Those customers, inevitably, are the best-suited to bypass the local utility to seek an additional source of energy. And that is where I think public service commissions have the obligation, working with those industrial customers and with the utilities, to look at alternative rate design programs, or economic development efforts to make sure that that bypass only occurs when it is economically justified.

Senator GRASSLEY. If this BTU tax is passed, and if it does cause loss of U.S. industry because of foreign competition, or, under the instance if it causes what we just talked about, it causes industries to leave the utility system, would this mean higher prices on residential and commercial customers who remain on the system, and then, consequently, cost-shifting?

Mr. NAGEL. That is always a possibility, Senator. In our State, I would tell you that is probably not a significant likelihood because none of our utilities have disproportionate reliance on industrial customers for their sales. But if you go to a State, such as Indiana or Illinois, where, perhaps—let me give you a better example.

Minnesota Power, which serves the taconite customers in Northern Minnesota, has over 60 percent of its load devoted to serving those major customers. If they left the system or shifted a major share of their power consumption off the system, yes, you would probably see some shifting, ultimately, of costs to other consumers.

The point being, to prevent that from happening, public service commissions, I think, are attentive enough to needs to encourage economic development in their States. They would work very closely with the utility and their industrial customers to see what kind of rate design changes can we make to obviate those concerns.

Senator GRASSLEY. Yes. Maybe, in closing, I would just comment on what Senator Rockefeller said last, and not in any way to pick a fight, because it is a new environment around here, and it ought to be a new environment.

But too often we sometimes think if you just increase rates or establish a new tax, that somehow it is static, it does not have an impact on people's behavior. And that sort of projection projects a massive amount of income that sometimes does not materialize, because tax changes do affect behavior, and, of course, behavior is part of what is behind the BTU tax.

But we are still assuming a lot of revenue coming in that might not, and, of course, we do have, from the last tax bill, the tax on boats, where we know that it has just about destroyed the industry in the Nation because people do not have to buy boats, so they haven't. Or, if they have, they have gone someplace else to buy them.

Senator BAUCUS. Thank you, Senator. Senator Chafee.

Senator CHAFEE. No thank you.

Senator BAUCUS. Thank you. Thank you all very much for your testimony.

Senator BAUCUS. The next panel consists of Mr. Leland Swenson, President of the National Farmers Union.

Mr. Paul Huard, vice president of the Taxation and Fiscal Policy Department of the National Association of Manufacturers.

John Buckley from Massachusetts on behalf of the New England Fuel Institute and various other associations.

Mr. Gordon Aoyagi, chief of the Division of Transit Services, Montgomery County Department of Transportation, Rockville, MD, on behalf of the American Public Transit Association.

And John Collins, senior vice president, American Trucking Associations, Inc.

Mr. Swenson, why don't you begin?

STATEMENT OF LELAND H. SWENSON, PRESIDENT, NATIONAL FARMERS UNION, DENVER, CO

Mr. SWENSON. Thank you, Mr. Chairman and members of the committee.

I am Leland Swenson, president of the National Farmers Union. I represent over 250,000 family farmers and ranchers throughout the United States.

Members of the National Farmers Union support the basic concepts outlined in President Clinton's economic program.

We believe there is a need to stimulate the economy, especially the rural economy throughout the United States.

We believe that it is time to invest in people and our Nation's infrastructure, to reduce the Federal deficit, and to reform our Nation's tax system.

And I would submit to the committee a complete copy of my testimony and summarize, if I may Mr. Chairman, just to expedite the process.

[The prepared statement of Mr. Swenson appears in the appendix.]

Mr. SWENSON. But I would neglect my duties as a representative of a general purpose farm organization if I did not point out that production agriculture has already contributed a great deal to our National debt reduction.

As noted in the chart in my testimony, agriculture is the only entitlement program that has experienced a reduction of outlays in the past and is scheduled and will accept even more reductions in the future.

Because of their effect on both net farm income and the future competitiveness of agricultural exports, the Farmers Union has serious reservations concerning both the BTU tax proposal and the proposed increased in the inland waterways fuel tax.

But getting straight to the point, if farm income were up, there would be much less concern about the potential implications of those energy taxes on our industry and rural America.

Just to give you a brief snapshot of the financial condition of agriculture based on the current farm programs, the U.S. Agriculture Outlook Board in January estimated that 1993 net farm income would be in the range of \$42 to \$48 billion, down from the \$51 billion level in 1992.

That is a net range 12 percent drop. And it is finally a 17 percent decline in projected net farm income to say that the net average farm income of producers across the board is about \$16,236. So you take that projection based in January and now look at increasing, significant production costs.

FAPRI has estimated that when fully phased in in 1998, production costs for corn associated with fuel and lubrication, fertilizer, chemicals and harvesting operations would increase by \$2.34 an acre.

And if you take a look at cotton and put those same factors in, it is \$3.37 per acre.

Farm production expenses for fertilizer for petroleum-based fuels and oils, electricity and custom work would rise by \$690 million in 1998 under the proposed energy tax.

Farm income is affected by 2.3 percent or \$1.2 billion by the total economic package.

North Dakota State has done a study which is referred to in my comments, and one has been done in my home State of South Dakota. They show that there is significant impact.

The point I want to emphasize is that the agricultural sector, unlike many of the other sectors of industry, is unable to pass those additional costs on. And thus, the only place to recover them is by higher returns for the commodities we produce.

We cannot just assess a higher cost for those commodities as we go to the market. And modern agriculture is energy intensive today. And we have few alternative energy sources in the production of food.

Independent farmers and ranchers have virtually, as I said, no way to pass through the increased burden to the end users of the food and fiber.

But beyond just that of production agriculture, let me just share some other concerns that exist in the rural communities. According to the Census Bureau, each rural family generates 62 percent more in daily auto travel than do those in metropolitan areas.

And only a small percent, 1 percent of rural workers, have access to public transportation. And heating and fuel costs for rural structures can average 15 percent more than metropolitan areas because of the isolated location and the exposed positions of rural buildings and the delivery costs of energy.

As we point to those concerns, what do we see are some of the solutions? First of all—and I know that it is beyond the jurisdiction of this committee, but first of all is income, the price for the commodity.

The Farmers Union is working with Congress and the administration to make sure that we can boost agricultural income in the rural economy to absorb some of the increases in BTU tax.

Another alternative would be that there would be an exemption for that used for the production of agriculture.

Another option would be to eliminate the energy tax and replace the amount of revenue by either decreasing investment proposals or I would favor an increase in the progressivity of the income tax.

Another approach would be to provide credit for energy generated by renewable resources, such as windmills and solar.

And we commend the Secretary of Treasury for excluding ethanol from the BTU tax as a way to increase the usage of that commodity.

We look forward to working with this committee.

Thank you, Mr. Chairman.

Senator BAUCUS. Thank you very much, Mr. Swenson.

Mr. Huard.

STATEMENT OF PAUL R. HUARD, VICE PRESIDENT, TAXATION AND FISCAL POLICY DEPARTMENT, NATIONAL ASSOCIATION OF MANUFACTURERS, WASHINGTON, DC

Mr. HUARD. Thank you, Mr. Chairman.

I am pleased to be here to present the views of NAM's more than 12,000 manufacturing members, all of whom are significant users of energy.

NAM believes the President is correct in concluding that significant reduction of the Federal deficit is essential to long-term U.S. economic growth.

Just as importantly, he has accurately focused on our need for less emphasis on immediate consumption and more emphasis on the private investment that is so essential to both productivity improvement and job creation.

However, while the administration has proposed BTU taxes, a well intentioned effort to tax consumption, it is to a significant extent rather a tax on industrial production.

As such, this tax would unilaterally increase the cost of U.S.-produced goods relative to foreign-produced goods thereby impairing U.S. competitiveness in both domestic and overseas markets.

NAM therefore opposes the proposed BTU tax for the following reasons. It would significantly damage the U.S. economy. By 1998, we estimate GDP would be \$38 billion than otherwise. And there would be 610,000 fewer jobs in the economy.

While the net amount of deficit reduction achieved by this new tax would be less than half the amount being predicted, it would have a very uneven impact by geographic reasons.

Some States are more than four or five times energy intensive as other States most adversely affected in the south or the west.

The impact on the manufacturing industry would be even more uneven. Some manufacturing lines are as much as 100 to 150 times as energy intensive as others.

The lines most adversely affected would be fertilizers, cement, refined petroleum products, paper, metals, and chemicals.

And then, probably most importantly, the injury to U.S. manufacturers caused by the BTU tax is unilateral.

It does not affect foreign-based production nor is there any legal way under the general agreement on tariffs and trade to impose a similar cost penalty on such foreign production.

Now, much is made by supporters of this tax is the fact that, well, even after the tax, you will still have lower energy cost than most of your competitors.

I do not hear the advocates of that line of argument pointing out that while we may have lower energy costs relative to most of our foreign competitors, we have higher wage costs.

We have higher costs for employee and retiree health care. And we have higher costs for complying with the torrent of product liability litigation. We have higher costs in environmental compliance.

All of these costs go into the price of the product. Unilaterally raising one of the few areas we have an advantage is not going to help U.S. competitiveness.

NAM does agree, however, that we need to increase the relative tax burden on consumption. The BTU tax just happens to be the wrong approach.

All of the negative attributes of a BTU tax, outlined above, can be avoided by levying a general national consumption tax, such as a value-added tax, at a single rate on the broadest possible base of both goods and services.

A particular design advantage of the VAT is that it would apply to imports into the U.S., but not the exports from the U.S.

In conclusion, NAM urges the committee to drop the proposed BTU tax. To the extent tax increases are required for deficit reduction purposes, NAM believes a broad-based general tax on consumption will do the least amount of harm to the economy, will avoid damage to our international competitiveness, and with proper adjustments to offset regressivity, will be the most uniformly fair across all social, regional, and economic sectors.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Huard appears in the appendix.]
Senator BAUCUS. Thank you, Mr. Huard.

Mr. Buckley.

STATEMENT OF JOHN G. BUCKLEY, COTUIT, MA, ON BEHALF OF THE NEW ENGLAND FUEL INSTITUTE, EMPIRE STATE PETROLEUM ASSOCIATION, FUEL MERCHANTS ASSOCIATION OF NEW JERSEY, OREGON PETROLEUM MARKETERS ASSOCIATION, AND INDEPENDENT PETROLEUM DISTRIBUTORS FROM MICHIGAN, MINNESOTA, DELAWARE, AND PENNSYLVANIA

Mr. BUCKLEY. Thank you, Mr. Chairman. Good morning.

I am here today representing 3,500 small, mostly family owned businesses who sell heating oil: heating fuels to homes, nonprofit institutions, towns, cities, businesses, and farmers.

I represent heating oil dealers from Oregon, Minnesota, Michigan, Delaware, Pennsylvania, New Jersey, New York, Connecticut, Rhode Island, Massachusetts, Vermont, Maine, and New Hampshire.

We do support the BTU tax. Our problem with the BTU tax, as initially presented by the administration, was the unfairness that came from the supplemental tax on oil.

I am here today to discuss three issues really. The first of which is the non-binding resolution passed by the Senate a few weeks ago known as the Kennedy Amendment, co-sponsored by Senator Mitchell, Senator Moynihan, and Senator Chafee from this committee.

I know it is not binding on this committee or on the administration, but we were heartened when more than two-thirds of the members of this committee voted for that amendment.

And the administration has responded partially to the amendment, but the key word is partial. There are two problems. First of all, the Treasury regulations and changes apply only to Number 2 heating oil used for residential heating.

Senator Mitchell made it very clear in his statement that all heating fuels should be exempt: kerosene and propane, also used for heating. The omission of kerosene is particularly hard on the rural poor.

I would like to hand to the committee a new study that has just been published on the impact of the BTU tax on the poor prepared by the Economic Opportunity Research Institute. The two authors are people who have spent the last decade on the LIHEAP Program.

It does point out that the rural poor, as my colleague noted, bear the burden much more. And many of them live in trailer homes. And they use kerosene for space heating.

Excluding kerosene as one of the heating fuels will only have an impact of about \$22 million in lost revenue, very, very small, but very important.

Second, the Treasury proposal exempts only residential customers, subjecting all non-residential users for heat to the 59.9 cent BTU tax, that is, the supplementary tax, which is almost two and a half times higher than that imposed by customers who happen to be on another fuel. It is unduly burdensome.

Senator Kennedy made it clear that he wanted churches and schools and colleges and municipalities, towns, town buildings, businesses, stores, farmers, and others not to have to pay the supplementary tax for heating.

These are accounts which we call commercial accounts. They represent about 40 percent of our business. We compete with natural gas.

Please understand, the supplemental oil tax, because it is so much higher will, if we are not given relief on these accounts, will end inter-fuel competition for these accounts.

And do not forget that when you market natural gas in a given locality, you have a monopoly. There are no other gas companies that you compete with. The competition comes from home heating oils.

When you give one fuel an enormous advantage over the other because of a differential tax policy, you are, in effect, signaling the end of inter-fuel competition, particularly since all of these taxes are going to be indexed. And they are going to be rising, which means the differential will rise as we get out into the out years.

Moreover, the way the Treasury has handled these non-residential users is to impose an excise tax directly on the end user. This creates another half million new taxpayers who will be paying excise tax directly and will represent an administrative impossibility.

We do, as I said at the beginning, support a BTU tax, but it must be fair. It must treat all customers equally. That was the essence of the Kennedy Amendment.

The Treasury has responded partially. And we urge this committee to fully implement the Kennedy Amendment.

I think the ideal solution from the standpoint of administration is to expand it slightly to include all off-highway users of diesel. That would solve a lot of the farm problem because their diesel would not be subject to the supplemental tax.

Mr. Chairman, I would also like to touch on the fact that inter-fuel competition between heavy industrial fuel and natural gas is similarly going to be negatively impacted by the supplemental tax.

And here again, you've got competition between oil and gas and coal supplying utilities, manufacturing, large apartment houses, hospitals.

This committee, with all of its anti-trust background, it is ironic to be put into a position where you are putting through a tax program that ends competition between fuels.

Mr. Chairman, I think there are solutions to this problem. I think you can design a fair BTU tax that does not have bias against one fuel. We certainly would be happy to discuss that with you.

We are ready to bear pain, our share of it fairly. We think the committee should place the same burden in price increases over all end users.

Thank you.

Senator BAUCUS. Thank you, Mr. Buckley.

Mr. Aoyagi.

**STATEMENT OF GORDON A. AOYAGI, CHIEF, DIVISION OF
TRANSIT SERVICES, MONTGOMERY COUNTY DEPARTMENT
OF TRANSPORTATION, ROCKVILLE, MD, ON BEHALF OF
AMERICAN PUBLIC TRANSIT ASSOCIATION**

Mr. AOYAGI. Good morning, Mr. Chairman and committee members.

First of all, I compliment you on the pronunciation of my name. You did an excellent job.

Senator BAUCUS. I had to work on it. Thank you. [Laughter.]

Mr. AOYAGI. You have spent some time obviously on the west coast.

My name is Gordon Aoyagi. I am the chief of the Division of Transit Services, Montgomery County Department of Transportation of Rockville, MD, and representing the American Public Transit Association today.

Thank you for giving APTA this opportunity to testify on the BTU tax and other issues.

Today is Earth Day. And the transit industry is proud to be part of the pollution solution for economic growth.

Additionally, we support thousands jobs in transit agencies: bus, rail car, and equipment manufacturing firms, construction projects, energy companies, and other sectors of our economy.

With full funding of the transit program authorized by the visionary Intermodal Surface Transportation Efficiency Act, or otherwise known as ISTEA, transit can do even more to protect the environment, reduce congestion, maintain competitiveness, and create jobs.

If this vision is to prevail, we need your help in coordinating Federal policies, funding, and tax incentives that benefit transit, not constrain it.

We applaud and support the administration's efforts to reduce U.S. dependence on imported oil and limit vehicle emissions.

Transit's primary contribution to each of these goals is to provide an alternative to the single-occupant vehicle which is the principal source for rising fuel consumption and certain air pollutants.

One person using transit for a year, instead of driving alone, saves more than 75 pounds of pollutants and over 200 gallons of gas a year.

If transit is not exempted from the BTU tax, it would cost transit agencies about \$93 million more per year to operate our services.

That is real money to transit agencies that have been under very tight fiscal constraints for more than a decade.

Transit can only respond to these additional expenses by raising fares, cutting services, or postponing maintenance and new capital investments.

Surely, this cannot be the vision of the future that we held when we passed ISTEA.

We urge you to exempt transit from the BTU tax. APTA only seeks equity in this exemption, to promote conservation.

The tax exempts oxygenates because they promote cleaner burning when mixed with gas. Transit can top that. The transit rider's car left at home does not burn any fuel at all.

The revenue loss would be very small. By fiscal year 1997, the BTU tax would generate about \$22 billion, with transit accounting for less than six-tenths of 1 percent or about \$100 million of that amount.

Other Federal mandates are already placing demands on constrained transit resources: the Americans with Disabilities Act, the Clean Air Act, and now, the impending Federal drug and alcohol testing requirements.

These Federal mandates will cost transit agencies several billion dollars per year in providing our services.

They will make it harder for us to compete against the single-occupant vehicles that are subsidized by over \$300 billion per year, according to the World Resource Institute.

We need your help and urge transit's exemption from the BTU tax.

I would also like to take the opportunity to talk about two other tax issues. First of all, thanks to the leadership of this committee, the new transit pass reform act will encourage commuters to use transit.

This law allows employers to provide employees up to \$60 per month in transit benefits. This benefit can be greatly enhanced at no cost to the Treasury by including it in the cafeteria menu of benefits that employers can provide to their employees.

Second, we support legislation to exempt commuter railroads from the 2.5 cent per gallon excise tax on diesel fuel passed in 1990.

Last year, Congress passed legislation to correct this mistake as part of the tax bill, but it was vetoed by President Bush.

This year, it is part of H.R. 17 which is now pending in the House Ways and Means Committee. We urge your support when your committee considers this tax legislation.

Mr. Chairman and members of the committee, we can begin to end real gridlock and improve our transportation systems by exempting transit from the BTU tax, extending the expiring 2.5 cent gas tax, and allocating it to surface transportation trust funds with a minimum of 20 percent going to mass transit accounts, exempting the commuter rail from the 2.5 cent tax on diesel fuel, and making transit passes part of the employee cafeteria plan.

Thank you.

[The prepared statement of Mr. Aoyagi appears in the appendix.]

Senator BAUCUS. Thank you, Mr. Aoyagi.

Mr. Collins.

STATEMENT OF JOHN J. COLLINS, SENIOR VICE PRESIDENT, AMERICAN TRUCKING ASSOCIATIONS, INC., WASHINGTON, DC

Mr. COLLINS. Mr. Chairman, Mr. Conrad, Mr. Chafee, my name is John Collins. I am senior vice president with the American Trucking Associations which is a national trade association of the trucking industry.

As a final witness on the final panel, I think it is very important for me to get right to the bottom line today. I know you do have a busy day today.

Our bottom line is that the trucking industry is prepared to do its fair share for lasting economic improvement, but we do not believe that it is fair to require trucking companies to make disproportionate sacrifices for goals that are really intended to benefit all Americans.

Let me make four specific points. The first one is that ATA does not oppose a broad-based level energy tax that taxes all fuels at the same rate, even though we are an energy-intensive industry, but the administration's proposed tax would fall more than twice as heavily on transportation users than on other energy sources.

As it stands, we believe the plan is neither fair nor balanced and must be adjusted. The President wisely rejected an overt fuel tax that would have fallen heavily on western States. We believe that the committee should act to make sure that a camouflaged fuel tax labeled as an energy tax is not enacted.

The second point is, we do not believe that the tax should be indexed. There has not been a whole lot of talk about that today, but we are concerned that indexing the tax would add to its unfairness and would be a significant step away from Congressional oversight of tax rates. The committee needs to stay involved in how those tax rates play out.

Third, we applaud the recent recommendation of the administration to move the 2.5 cents per gallon general fund fuel tax into the highway trust fund. We believe that the full amount should go into the highway account and be spent as provided in the Intermodal Surface Transportation Efficiency Act of 1991. This would allow the transfer to transit at local initiative.

Fourth, do not cut back the business meal deduction for truck drivers whose very modest, on-the-road expenses, we believe, are fully justified business expenses.

Let me turn to some of the specifics of our position on the BTU tax. Our number one concern is the form of the proposed energy tax.

Although ATA would prefer that energy-intensive industries not be subject to a new energy tax, we would not oppose a truly broad-based and level energy tax that taxes all fuels at the same rate.

However, a tax that hits the only fuel that is available to trucks at a rate that is 2.3 times the rate that applies to users of other energy sources while allowing more than a dozen exemptions constitutes a camouflaged fuel tax.

It is not fair. It is not balanced. And we believe it must be changed.

I will put some numbers around this. The 1996 rates would amount to 7.5 cents per gallon for gasoline and 8.3 cents per gallon for diesel fuel based on the heat content of the fuel. At 1996 rates, commercial truck owners would have to pay roughly \$2.9 billion in added fuel tax. That is roughly 10 percent of the total gross revenue projected from the new tax.

We believe that this burden is totally unfair, given that trucking accounts for less than 5 percent of the gross domestic product.

If you want to look at that another way, Mr. Chairman, at 1992 profit levels, that tax alone would account for 50 percent of the industry's profits. So it is a tremendous burden on our industry.

Truck owners and other highway users have already been paying more than their fair share for deficit reduction. Since the 1990 budget agreement, 2.5 cents of the fuel tax has been going into the general fund. That has added \$900 million per year to the fuel bill of commercial truck operators.

Administration officials have mentioned, but not specified externalities or environmental costs associated with petroleum, but there are already a wide variety of explicit and hidden environmental taxes on petroleum and various products.

Many States have similar taxes, some at even higher rates than the Federal taxes. And by October 1993 of this year, highway diesel

fuel tax will cost an estimated 4 to 7 cents per gallon to comply with recent Clean Air Act rules.

Adding the administration's camouflaged 8 cents per gallon fuel tax to the diesel tax from the Clean Air Act effective tax means that the truck operators will be paying as much as 15 cents per gallon for purposes that do nothing to build highways or transit systems.

These non-highway diesel fuel tax levies are on top of 20 cents a gallon Federal highways tax and State taxes that may reach 33 cents.

Mr. Chairman, perhaps most important is that long-haul trucking really does not have a viable alternative when it comes to alternative fuel options.

Because of the lower BTU content of alternative fuels, if we switch to an alternative fuel, it adds weight to the truck, which means we carry less cargo, which means we have to put more trucks out on the road.

So we think there is a boomerang effect here. If the propulsion system becomes heavier, then the result is going to be counter-productive.

Our bottom line recommendation is that if a broad-based energy tax is adopted, we urge you to lower the rate on petroleum to the same level as other fuels.

Our written statement, Mr. Chairman, deals with some other issues.

In summary, the trucking industry is certainly willing to make its share of sacrifices if it will contribute to long-run, non-inflationary growth, but we believe that any sacrifices must be fairly shared.

Thank you.

[The prepared statement of Mr. Collins appears in the appendix.] Senator BAUCUS. Thank you very much, Mr. Collins.

Mr. Aoyagi, you suggested that the 2.5 cents Federal gasoline tax be divided so that 20 percent would go, I guess, to the mass transit account and 80 percent would go to the surface transportation and highway account.

As you probably know, in other words, it is called the Byrd Rule here, not Senator Robert Byrd, but Senator Harry Byrd, a former member of this committee.

If projected revenues in the surface transportation account and the highway account are projected to be deficient, automatic payments to States must be proportionately reduced.

The projections show that in the next several years that the Byrd Rule will be triggered, that is, even with the 2.5 cents, even 2 cents going back from deficit reduction to the highway account, still the Byrd Rule is going to be triggered, that is, there is not going to be enough money in the highway account in about three, four, or 5 years from now.

At the same time, the mass transit account is pretty flush. It has \$8 billion, I think, in surplus. And it is projected to stay in surplus.

Why doesn't it make more sense for the 2.5 cents to go fully to the highway account rather than 20 percent of it to go to an account that is already flush when, again, the other one is about to go belly up?

Mr. AOYAGI. Well, it seems to me, Mr. Chairman, I think we have to look at the root cause of why the mass transit fund account appears to look flush.

You might recall that predictable sources of funding for mass transit have not been forthcoming in the last 10 years. And so the ability of transit agencies to plan capital investments that will spend at a predictable and stable rate, like the highway industry has, we have not been able to do that.

There is a lot of pent-up demand for transit. ISTEA captured that vision and, in fact, allowed local decision-making to transfer some of that funding to transit, but there are a lot of communities in the area that are looking for transit solutions.

That will take significant amounts of capital investment. And we think to establish the balance for that is what we need.

Senator BAUCUS. Thank you. I have more questions here.

Mr. Swenson, I also share a deep concern about the effect of a BTU tax on agriculture. Some on the other side, however, say that the earned income tax credit increase will take care of that. Your response.

Mr. SWENSON. Well, the fact is is that it will not deal with all of the results.

The anticipated offsets from the changes in the earned income tax credit will do little to help especially the smaller farmer whose average age is 55 or over with no children at home, nor will any allowance for an investment tax credit because the proposal on the investment tax credit excludes used equipment. The main investment that they are making in equipment is in used equipment.

Senator BAUCUS. Could you expand a little more on particularly the earned income tax credit? Because that is where a lot of opponents to this BTU tax rely on.

Mr. SWENSON. Well, when you take a look at—

Senator BAUCUS. As it affects agriculture.

Mr. SWENSON. Sure. As we take a look at further reductions in net farm income and when you take a look at the fact that you've got in 1990 two-thirds of what FAPRI classified as small farmers, which makes up 75 percent of all the farmer's income with sales less than \$50,000, they are experiencing a loss. They are in a negative earning position in their operation.

Their only income comes from off-farm jobs. And so really you do not have an earned income situation in which to have credits to be applied against. And so you cannot gain back that actual outlay in cash.

Senator BAUCUS. Thank you.

Senator Chafee.

Senator CHAFEE. Thank you, Mr. Chairman.

Mr. Swenson, I was astonished to read your statistics about small farms in the United States. You stated at the bottom of page 1 of your testimony that 75 percent of all farms have sales of \$50,000 or less.

Assuming they make a maximum of 10 percent on their sales, these farmers have a total net income of something probably less than \$5,000.

And, indeed, then, you go on to say that two-thirds of these farms lost money. How do they keep going?

You go on to say that they only remain solvent through off-farm jobs. Those are astonishing statistics. Are these recent statistics?

Mr. SWENSON. Yes. They are. They are from USDA. And they are up to date statistics.

Senator CHAFEE. Well, they certainly are discouraging statistics.

Here is our problem. Every witness here has said two things: first, they are not opposed to wrestling with the problem of the Federal deficit. Everybody wants to be helpful.

Second, everybody wants to maintain his or her competitive position. Mr. Buckley points that out with respect to natural gas competition and there are other examples as well.

Let me explain how I approach this problem. The first thing I look at is how a particular tax proposal is going to affect our international competitive position?

This probably does not affect Mr. Aoyagi.

Senator BAUCUS. Aoyagi.

Senator CHAFEE. Aoyagi, I thank Senator Baucus for that clarification. But it does affect what you are doing and what Mr. Huard is doing. In other words, if we boost the cost of producing our export products, then, we will not be as competitive.

The second thing I consider is what a proposal will do to the competitive position within the country, for example, trucks versus rail, gas versus oil, and so forth?

And it seems extremely difficult to come up with some formula that, indeed, is fair.

And then, we take into consideration non-tax factors. For example, we consider it good to encourage mass transportation because that gets people off our highways. And that is why we subsidize Amtrak and mass transit in general.

Suppose we just went to a straight gasoline tax increase for non-commercial vehicles, or have an exemption for noncommercial vehicles.

Now, it does not seem to me that would affect our competitive position. And that would still create some environmental benefits. What do you think of that?

Well, let's start with you, Mr. Huard, just a straight 50 cents a gallon, just to try something with commercial vehicles. In other words, Mr. Collins' trucks would be exempt from that and tractors, too, Mr. Swenson's tractors. What do you say to that?

Mr. HUARD. Well, from a manufacturing standpoint, it would certainly pose less of a problem than the BTU tax for no other reason than gasoline—

Senator CHAFEE. Why would it propose—you say less of a problem. Why would it propose any problem?

Mr. HUARD. I think singling out any sector of the economy for excessive taxation is a problem. That is why we support a very broad, uniform rate, general consumption tax across the board on goods and services.

That is what will raise revenue and create the least amount of distortion in economic decision-making. Picking out a single sector, we think, is bad tax policy.

Senator CHAFEE. Well, I will guarantee you—

Mr. HUARD. Admittedly, gasoline is not a significant component of industrial production. It would be less of a problem than the

BTU tax, but that is as far as I will go at saying nice things about it.

Senator CHAFEE. Well, I will guarantee you, if we have a suggestion for a broad-based VAT tax, for example, there would be a line stretching down that hall of people who have justifiable reasons to oppose it.

Mr. HUARD. I would not be in it.

Senator CHAFEE. Well, you would be the only one missing I think. [Laughter.]

I do not want to take too much of my time.

Mr. BUCKLEY, what do you say about that?

Mr. BUCKLEY. Senator Chafee, I think you may have stumbled on something here. Most of the problems that—

Senator CHAFEE. Stumbled? Let's put it on a higher plane than that. [Laughter.]

Mr. BUCKLEY. Senator Chafee, in your erudite line of questioning— [Laughter.]

Most of our problems, whether trucking or farming or heating fuels, manufacturing industries that happen to be on oil, like the paper industry, airlines, chemicals, oil refining, the problem with this whole approach is that you have 2.3 times as high a tax on oil as on anything else.

If you got rid of that supplemental tax, you would get rid of all the exceptions. You get rid of the administrative difficulties.

To replace that money and still get the \$22 billion, you go back to the very low BTU tax that they started with 25.7 cents. And you add in a 7.5 cents gasoline tax, 2.5 cents a year, phased in over 3 years. You will have the same revenue.

And you already have the collection mechanism in place. You do not need to create a whole new bureaucracy to do it.

Senator Bentsen said in response to a question from the chairman on Tuesday that we have the lowest energy cost here. Our rates are low compared to Europe because they tax everything.

There is a new publication just out by the International Energy Agency of the OECD, which I happened to be reading the other night. And it studied Germany, Japan, Denmark, Canada, the United States, a number of the OECD Nations.

I just want to read one sentence from that. It is talking about the German VAT. "As in most European countries, the VAT is refunded at 100 percent for all purchases for commercial purposes. This means that no VAT is collected for industry use of energy, for energy use in electricity generation, or in automotive diesel."

Now, see, what the Europeans and Japanese do is protect their industry from higher cost and make them more competitive.

What we are doing is shooting ourselves in the foot with really what amounts to an all import tax with this supplemental tax on oil.

Senator CHAFEE. Okay. My time is up.

Senator BAUCUS. Right. Thank you very much.

Thank you, Senator.

Senator Conrad.

Mr. BUCKLEY. I will give the committee this new International Energy Agency booklet because I know you are interested in how other countries deal with energy.

Senator BAUCUS. That will be very interesting. We appreciate that. Thank you.

Senator Conrad.

Senator CONRAD. Thank you, Mr. Chairman.

Let me just say that Senator Chafee through his erudite questioning has perhaps stumbled on something that really is important.

The thing that I am very concerned about is that we are being told that Europe has much higher levels of taxation on energy than we do.

And if you look at it on an aggregated basis, that is true. Unfortunately, industries do not operate on an aggregated basis.

They operate on a disaggregated basis. What matters is the effect directly on an industry, not the total energy cost or the sector costs by country.

I have asked my staff, if you take out the very high taxes they pay on gasoline and diesel for individual consumers, what does the picture look like then?

What does the picture look like then? I guess it would look far different knowing how high fuel taxes are in Europe.

We may really have a much different picture emerge in terms of what we are doing to our competitive position by imposing a tax like this one.

So I think Senator Chafee is asking the right questions. And I think we've got to make certain we know the answers before we ourselves stumble ahead and do something that would be very counter productive for the competitive position of the United States.

The whole question of aggregate effects goes to the heart of the point I want to make here this morning that affects my specific constituency. Aggregate effects often mislead.

The other day, we had the Secretary of the Treasury here. He was talking about the effect on the incomes of people of various regions of the country. The average effect was about six-tenths of 1 percent of their income.

I pointed out then that we should look at a specific industry and a specific effect on that industry. I look at agriculture, and my State is one of the most agricultural in the Nation.

Let's look at the average income in my State for the average size farm—the average size farm is 1,200 acres. The average income for that size farmer is \$17,600.

Mr. Swenson, I thought your testimony was superb. I had a chance to read it this morning. I thought you made the point very, very well.

People have an incredible misperception of agriculture in this country. There are some farmers that are well-to-do, absolutely, not many of them, a very low percentage.

The fact is most farm producers in this country are very small. Average income in my State for the average size farm is \$17,600. The average BTU tax effect would be \$1,200.

By my calculation that is 6.7 percent. It is not six-tenths of 1 percent. It is 11 times the effect on the average person in this country.

Now earlier this week, we heard a lot of talk that the earned income tax credit is going to solve this problem for farmers.

Well, let's examine that. Let's go right to specific examples. This chart shows the effect of the EITC on North Dakota farmers. I have used my own State for obvious reasons, but we could plug in any farmer who is similarly affected.

Farm income again is \$17,600 for the average size farm, with an average BTU tax at \$1,200. Under current law governing the EITC, if you have no children, you get nothing. Under the Clinton proposal, no children means you get nothing. The EITC expansion means nothing if you have no children.

If you have one child under current law, you get \$1,013, under the Clinton proposal, \$995. You actually go down \$18 from current law.

With two or more children a family gets \$1,102 under current law, \$2,062 under the Clinton proposal, a \$960 increase.

So the point is, if you have no children, it is not going to help you. The EITC is not going to solve this BTU problem. If you have one child, it is not going to solve the problem.

And the fact is, we just got the statistics from our State. Mr. Swenson is exactly right. Thirty-eight percent of the people in our State who are farming are over the age of 55.

In general there are no children in this category. The EITC is not going to help them at all with respect to their BTU tax burden.

Let's go to the next chart and show where this leaves us then. Let's compare a farmer with a non-farmer and see how equitable the final burden is.

This chart shows the combined effect of the BTU tax and the earned income tax credit expansion, farmers versus non-farmers. The first column shows farmers with no children, and \$1,200, their BTU tax effect. Of course, a non-farmer does not have that effect.

With one child they have a \$1,200 BTU cost and they lose \$18 on the earned income tax credit proposal of the Clinton administration. The non-farmer would just lose the \$18. So again, the farmer is down \$1,200.

With two or more children, the farmer has gained \$960 on the earned income tax credit, lost \$1,200 on the BTU tax. So he is down a net \$240. The non-farmer is up \$960.

Where is the fairness in that? Where is the fairness in that?

That is the point I thought needed to be made today after what we were told earlier in the week about the earned income tax credit offsetting this problem. It doesn't. It doesn't. That is the bottom line.

You add in this incredible proposal of a 525 percent increase in the barge tax, which, Mr. Swenson, you indicate increases a farmer's cost 5 cents a bushel. That costs this farmer another \$2,400 in the State of North Dakota.

Now, that is not fair. It is not reasonable. If this Senator has anything to say about it, it is not going to happen because I will not vote for it.

I am not going to be alone because if you look up and down the line here, you've got a lot of us who represent these farmers. This isn't fair.

I hope somebody is getting the message somewhere. You add all of this up and it is too much. It creates a burden that is unfair and it cannot be allowed to pass.

Thank you, Mr. Chairman.

Senator BAUCUS. Thank you very much, Senator.

And I want to thank the panel very much for your testimony.

The hearing is adjourned.

[Whereupon, at 12:35 p.m., the hearing was concluded.]

APPENDIX

ADDITIONAL MATERIAL SUBMITTED

PREPARED STATEMENT OF EUGENE L. AMES, JR.

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE.

I am Gene Ames, Jr., chairman of Venus Oil Company of San Antonio, Texas, and chairman of the board of the Independent Petroleum Association of America (IPAA). I am pleased to provide for you these written views of the IPAA on the BTU tax.

At the outset, let me make clear that the IPAA does not support any tax on domestically-produced energy. Nonetheless, we are committed to work with the Administration and the Congress to mitigate the negative impacts that any change in tax policy may have on domestic oil and natural gas production. To that end, we urge the Congress to consider the BTU tax with a thorough review of its impacts on the present weakened condition of America's natural gas and oil producing industry.

IMPORT DEPENDENCE. America has vast undeveloped resources of natural gas and oil, yet our nation is rapidly losing a vitally important industry and is becoming dangerously dependent on imported oil. If current trends continue we could be importing the 17 million barrels of petroleum each day by the year 2010. This year, the U.S. is projected to import as much oil as we did in 1977, the peak year for oil imports.

REDUCED DRILLING. Independent producers drill 85 percent of all U.S. wells and produce about 60 percent of domestic natural gas and about 40 percent of domestic oil. We are eager for economic conditions which would allow us to increase domestically produced supplies of natural gas and oil. Yet drilling for natural gas and oil hit an all-time low last year, and this year looks no better. Except for the first six weeks of this year, when drilling was pushed up due to the expiring non-conventional fuels tax credit, drilling on a week-to-week has been significantly below the level recorded last year. We could be heading toward a new record low. Meanwhile, the domestic energy equipment and supply industries are deteriorating at an alarming rate.

PEOPLE LOSING JOBS. More than 450,000 people have lost their jobs in the industry over the last decade, more than in virtually every other U.S. industry. In the first quarter of this year, employment was down seven percent from the same period a year ago. We have lost more jobs than we have retained in the domestic oil and natural gas producing industry. These are real people--roughnecks and roustabouts who work on the drilling rigs, the seismic crews, the landmen, geologists, engineers, the well service contractors and their employees, the secretaries, bookkeepers, and the other folks who work in our offices. White collar and blue collar, skilled and unskilled, these people have one thing in common -- they are losing their jobs at an alarming rate.

We share President Clinton's priority to create jobs. We agree that there's no recovery worth its salt that doesn't put the American people back to work. We want to put back to work some of the nearly 450,000 people who have lost their oil and natural gas jobs in the past decade.

BTU TAX PROBLEMS. From an independent producer's perspective, there were fundamental problems with the Administration's initial BTU tax proposal. We immediately relayed those concerns to the Administration. We are encouraged that "collection point" was reexamined and that the Administration is now recommending several changes that will mitigate the impact of the BTU tax on the domestic industry. We are particularly encourage with the recommendation that collection points for oil and natural gas be moved downstream, although we support efforts to ensure that the tax is collected from the ultimate consumer.

COLLECTION POINT. Where the BTU tax is collected is critically important. Collecting the BTU tax, as was originally proposed, at the refinery input for oil or at the pipeline inlet for natural gas would have devastated producers, who are "price-takers" in the marketplace and are, thus, unable to pass along such taxes. Where oil is concerned, refiners would likely have deducted the tax from the posted price of oil, which we must accept if we are to sell our production. Collecting the tax at the refinery tailgate, as the Administration now proposes, is a significant improvement, but we would support efforts to move the oil collection point to the terminal rack.

The collection point for the BTU tax on natural gas is a vital concern for independents who produce 60 percent of the domestic supply of natural gas. The IPAA supports the testimony of the Natural Gas Council on the issue of natural gas collection point -- our joint recommendation is to move the collection point for natural gas downstream to the ultimate consumer, thus keeping the conservation benefit and preserving domestic production levels. It is important that no one segment of the natural gas industry be put at risk of having to absorb a part of the tax, if the nation is to achieve the long-term energy policy goals of expanding use of clean-burning natural gas. The natural gas industry is undergoing a much-needed, but economically painful restructuring. No segment of the industry can afford to absorb a significant part of the BTU tax and still be able to meet the expansion challenges which it faces under recently enacted energy statutes and regulatory changes.

Let me underscore the point that producers are not in a position to absorb any part of the BTU tax. Natural gas producers have been working on very tight profit margins in large part due to low natural gas wellhead prices. The proposed BTU tax on natural gas exceeds the average net earnings per million BTUs of this country's most efficient independent natural gas producers and is probably several times the typical producer's profit per million BTU.

The IPAA also recommends that the collection point for natural gas liquids be at the point that these products are odorized for commercial use. Normally, natural gas liquids sold prior to the point of odorization are used for exempt purposes.

The collection point is not the only concern we have with the proposed BTU tax.

SUPPLEMENTAL TAX ON OIL. In our view, there is no rational justification for a double tax on oil. It falls equally on domestic and imported oil and, thus, will not decrease our nation's oil import dependence one iota. By depressing oil demand, the BTU tax will tend to reduce oil prices, and reduced oil prices have a greater impact on domestic producer than on most foreign oil producers. We do not believe the BTU tax will achieve the Administration's announced goals for protecting the environment and reducing oil imports. In addition to the possible wellhead price impacts, we believe the BTU tax, as a whole, will increase the nation's import dependence because by raising the costs of both drilling and domestic production, especially production from marginal or "stripper" wells.

ENERGY USED TO PRODUCE ENERGY. To the extent that the BTU tax is levied on the energy used to produce energy, it will increase the costs of incremental and advanced oil and natural gas recovery and thus decrease domestic energy production. The Administration's exemption for oil and natural gas produced and consumed on the premises to produce oil or natural gas helps greatly. However, the greatest risk to the greatest number of wells will be the rising cost of electricity used, for example, to run artificial lift pumps and water disposal facilities. Of course, the BTU tax on any purchased fuel will increase the cost of drilling and production.

Marginal wells, in particular, will be hard hit. More than 90,000 of Oklahoma's 101,000 operating wells are on artificial lift, and most use electricity for that purpose. While Oklahoma is well-known as an energy-producing state, it is by no means alone in the high percentage of its wells that will be at risk due to the higher costs associated with the BTU tax. States like Kansas, Kentucky, Indiana, Ohio, New York, to name a few, have most of their production in low-volume, high-cost wells. (See attached map.)

ENHANCED RECOVERY. The IPAA also advocates that energy used to for enhanced oil recovery be exempted from the BTU tax. The Administration has recommended that natural gas used in the enhanced recovery of heavy oil be exempted. IPAA supports that recommendation. However, the exemption is too narrow should be expanded to include all energy purchased and consumed for enhanced oil recovery projects if we are to take advantage of the new domestic reserves that improvements in recovery technology are providing.

COMPRESSED NATURAL GAS. The Administration has recommended that two alternative vehicular fuels, ethanol and methanol, be exempted from the BTU tax. IPAA strongly recommends that compressed natural gas also be exempted from the BTU tax.

INFLATION ADJUSTMENT. Another point of contention is the inflation adjustment provision in the BTU tax proposal. The tax is on BTUs, not on energy prices; inflation affects the price of fuel and not their BTU content. The inflation adjustment is just build-in tax increase, and it should be dropped from the plan. Indeed, if the BTU tax is enacted, Congress should commit itself of a thorough review of its impact on the U.S. economy and domestic energy production, and for that reason the IPAA would support efforts to sunset the tax after a period of years.

TAX POLICY AND THE BTU TAX. Assessing the impact of the BTU tax on the domestic oil and natural gas industry requires that it be considered together with other tax policy proposals. Last year, as part of the Energy Policy Act of 1992, this Committee took a leadership role in advocating and supporting changes in the Alternative Minimum Tax (AMT) laws to reduce the penalty on capital investments in domestic natural gas and oil drilling. We are grateful, yet we must report that the industry continues to have difficulty attracting investment capital. In part, that difficulty arises from the fact that the investment benefits of those AMT tax changes can be and, for a while, were negated by falling oil or natural gas prices.

Further erosion of the value of last year's AMT reforms is inevitable under the higher personal AMT and regular tax rates proposed in the Administration's economic plan. These higher rates will hit the majority of IPAA members, who operate as sole proprietors, partnerships or Subchapter S corporations, increasing their tax rates by as much as 10 percent.

PRESIDENT'S INVESTMENT INCENTIVES. The President's proposed investment tax credit will not benefit most domestic natural gas and oil producers, because our principal investments are for drilling costs which do not qualify for the credit. Nor will producers be able to attract capital through the President's proposed capital gains reduction for small businesses, because the proposal specifically excludes stock in resource companies.

Investment capital is the life blood of our business and giving investment incentives to some small businesses while essentially excluding ours, obviously puts domestic producers at a competitive disadvantage in vying for investment capital. If the President and the Congress can provide a stimulus for investment in the domestic natural gas and oil industry now, there is still time to save the infrastructure of this industry. If this opportunity is missed now, many family owned independents will go out of business.

MARGINAL WELL PRESERVATION. More must be done to maintain domestic production levels. The domestic oil and natural gas industry, represented by IPAA and 44 state, regional and professional associations, developed a comprehensive agenda to revive the domestic industry. That "Unified Agenda" (attached) has as its central theme and top

priority the preservation of America's marginal wells. To that end, the IPAA strongly recommends that the Committee include in its legislation provisions to encourage investment in marginal well production.

Marginal wells, those that daily produce less than 15 barrels of oil and 90 thousand cubic feet of gas, are important to our overall domestic energy supply and are essential to maintaining the industry's service and supply infrastructure. Marginal wells provide at least, and probably considerably more than, 20 percent of domestic crude oil and 13 percent of our natural gas.

Legislation has been introduced by members of this Committee to provide tax changes designed to preserve marginal well production. I strongly encourage you to consider these proposals and include them or similar measures in any tax legislation passed this year by the Congress. We believe that a production-based credit for marginal wells, patterned after the successful non-conventional fuels credit, will do the most to stimulate needed investment in marginal wells. In addition, this type of credit will revive drilling activity in geological formations, such as Appalachia's tight sands and Michigan's Devonian shale, which benefitted under the now-expired Section 29 credit. A production-based credit would also help to offset the detrimental impacts on domestic production that are sure to result from enactment of the BTU tax and the Administration's other tax proposals.

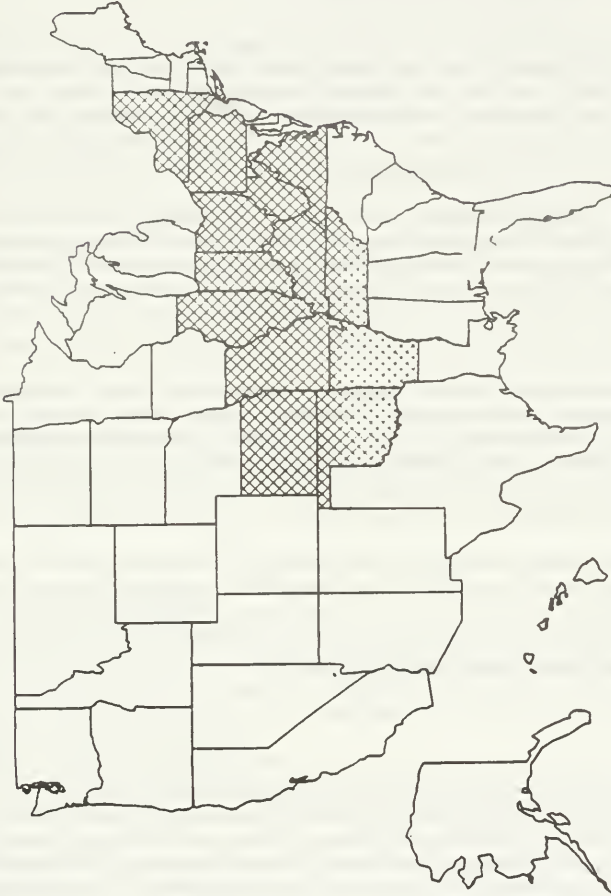
THE INDEPENDENT PRODUCER AGENDA

To Revive The Domestic Natural Gas and Oil Industry

Independent producers urge President Bill Clinton and the 103rd Congress to build upon the Energy Policy Act of 1992 to decrease America's dangerous and costly reliance on imported oil and petroleum products and to rebuild the weakened domestic natural gas and oil industry. We urge the President and Congress to support measures to encourage the development of both conventional and non-conventional natural gas and oil in this country, as well as measures which preserve and promote marginal natural gas and oil wells, by implementing the following initiatives:

- **CRUDE OIL.** Revise policies governing oil imports and exports to stabilize and expand domestic oil production and to prevent the premature loss of stripper oil production, including establishment of an import fee on crude oil and petroleum products and repeal of the ban on the export of Alaska's north slope crude oil; adopt policies that ensure a greater share of federal research funding for crude oil and technology transfer.
- **NATURAL GAS.** Implement recently enacted policies that expand domestic and international markets and make them more competitive, including full implementation of natural gas pipeline rate reform; adopt policies that ensure a greater share of federal research funding for natural gas and technology transfer, that encourage longer term sales contracts, that maintain a level playing field for domestic and imported natural gas, and that recognize the environmental benefits of natural gas for electric generation, industrial use and as a transportation fuel.
- **TAXES.** Adopt policies that encourage capital formation for oil and natural gas exploration, development and production, that encourage the maximum recovery of the domestic oil and natural gas resource base through initiatives to maintain existing marginal production and the use of advanced recovery technology, and that improve the economics of environmental protection. Oppose any new tax imposed on energy at the wellhead.
- **ENVIRONMENTAL PROTECTION.** Support environmental proposals that are equitable, cost effective, and which prevent documented environmental harm; work to change existing laws that do not meet these requirements; support retention of the present state-based regulatory program for oil and natural gas exploration and production wastes, and ensure that the present federal policy that exempts such wastes from designation as hazardous waste is retained under the Resource Conservation and Recovery Act (RCRA), the Comprehensive Environmental Response Compensation and Liability Act (CERCLA), and is incorporated into other appropriate statutes and regulations.

STATES WITH 50% OR MORE STRIPPER WELL PRODUCTION



% of Total Crude Oil Output produced by Stripper Wells

| | | | | | | | |
|----------|------|----------|-----|--------------|------|-------------|------|
| Arkansas | 52% | Kentucky | 83% | Ohio | 73% | Tennessee | 81% |
| Illinois | 93% | Missouri | 86% | Oklahoma | 75% | Virginia | 100% |
| Indiana | 100% | New York | 88% | Pennsylvania | 100% | W. Virginia | 99% |
| Kansas | 71% | | | | | | |

PUBLIC LAND . Adopt policies to improve and increase access to federal lands for oil and natural gas exploration and production under reasonable terms and conditions.

Approved by the IPAA Executive Committee
February 6, 1993

PREPARED STATEMENT OF GORDON A. AOYAGI

Introduction

Mr. Chairman and Committee members, my name is Gordon Aoyagi. I am Chief of the Division of Transit Services, Montgomery County Department of Transportation, of Rockville, Maryland. Thank you for giving the American Public Transit Association (APTA) this opportunity to testify on President Clinton's proposed broad-based energy tax and other tax issues that affect the transit industry.

The U.S. transit industry is a powerful tool for economic growth. We serve more than 10 million customers each weekday, and our riders make a total of 8.6 billion trips each year. Transit agencies serve the nation's cities, suburbs, and more than 3,000 rural counties. They employ 282,000 workers who receive compensation of \$11.5 billion annually. We support thousands of jobs for workers in bus, rail car, and equipment manufacturing firms, construction workers on our capital projects, and employees in all sectors of the economy.

With the right mix of federal tax and investment policies, our industry can do even more to sustain economic growth, create jobs, and improve productivity by eliminating transportation inefficiencies. If transit reaches its full potential, all Americans will benefit from cleaner air, reduced congestion, a greater range of convenient transportation choices, and improved quality of life in our cities, suburbs, and rural areas. For these reasons, we thank the Committee for its past, and we hope future, support of tax policies that promote transit use.

The transit industry welcomes the Administration's economic program as a long overdue effort to set our nation's priorities straight. This Administration understands that one key to economic revitalization is to bring transit funding closer to the levels authorized in the visionary Intermodal Surface Transportation Efficiency Act (ISTEA). These investments are needed to create a surface transportation network that enables our economy to function effectively and productively.

Mr. Chairman, you and your colleagues on this Committee must ensure that our tax system works in concert with other government policies to achieve, rather than frustrate, the goals established in ISTEA, the Clean Air Act Amendments of 1990, the Americans with Disabilities Act (ADA), and last year's energy policy act. Today, I would like to evaluate the effect of various tax proposals on these national goals.

Btu Tax

The President has proposed a tax based on the British thermal unit (Btu) content of different energy sources, with the revenues to be used for deficit reduction. The transit industry is prepared to support the Btu tax because it is a cornerstone of the Administration's economic revitalization program. We believe that this program, in its entirety, strikes a good balance in its efforts to reduce the deficit, to fund essential investments in our economic future, and to modify the tax structure to encourage energy conservation and discourage pollution.

To enhance the Administration program's effectiveness, we believe that you should eliminate or compensate for any of its potential adverse impacts on transit. This is in the best interests of the Administration's program, it is consistent with the goals of the Btu tax, and it is essential for successful implementation of ISTEA.

The transit industry approaches tax issues with two concerns -- maintaining a reliable source of revenue for federal surface transportation programs and ensuring that tax policies encourage conservation and other benefits to society. For these reasons, APTA has supported increases in the federal excise tax on gasoline, with revenues dedicated to transit and other surface transportation programs.

We agree with the Administration that the Btu tax will have positive environmental and energy benefits, largely because it would increase the cost of gasoline. When fully phased in, the Btu tax is estimated to add 7.5 cents to the price of a gallon of gasoline, or 5.7 percent of the total cost. From what we know about the elasticity of demand for gas, an increase of this magnitude will have an impact on driving behavior, but not a substantial one. Supporters of higher gas taxes usually argue that increases on the order of 50 cents per gallon would be needed to reduce demand substantially.

The Btu tax would also significantly increase costs to the public agencies that provide transit service. APTA estimates that it would add \$29 million to the annual operating costs of transit agencies in FY 1994, \$60 million in FY 1995, and \$93 million in FY 1996. The tax would increase transit operating expenses through its impact on the price of fossil fuels, electrical propulsion power used by rail systems, and utilities. In 1991, the transit industry spent \$510 million to purchase 670 million gallons of diesel fuels and 40 million gallons of gasoline. We spent about \$575 million on electrical power propulsion and utilities.

Federal policies should encourage, not discourage, the use of transit. If the entire cost of the Btu tax to the transit industry were passed on to our riders in the form of higher fares, the result would be a 0.6 percent reduction in ridership. That's only 50 to 55 million fewer trips per year -- a small share of the nearly nine billion annual trips on transit. But, any reduction is unsatisfactory if we are concerned about reducing air pollution, conserving energy, or fulfilling the promise of ISTEA. Substantial increases in ridership are essential to achieve these objectives.

Transit agencies don't necessarily have to raise fares to pay for increased costs. They can reduce services, defer operations and maintenance expenses, and postpone capital spending. Unfortunately, all of these options threaten ridership because they make it harder to provide dependable, convenient service. The costs of the Btu tax will hurt the transit industry, especially since they will be felt at the same time as the costs of complying with the ADA, the Clean Air Act, and recent energy legislation. The total impact of these federal mandates could be as much as several billion dollars per year.

Protecting the Environment

We support the goal of protecting the environment through tax policies that reduce smog and greenhouse gas emissions. Up to 110 million Americans breathe air that is unhealthy, and air-pollution related illnesses add \$40 billion to our yearly health care bill. By 1994, vehicle emissions will begin to rise for the first time since 1970, as more driving outweighs the gains from cleaner tailpipes.

It is important to ensure that any tax changes encourage transit use, since our industry's greatest contribution to a clean environment is to provide an alternative to single-occupant vehicles, the greatest source of transportation-related pollution. All forms of transit significantly reduce pollutant emissions compared to single-occupant vehicle driving. One person using transit for a year instead of driving alone saves 9.1 pounds of hydrocarbons, 62.5 pounds of carbon monoxide, and 4.9 pounds of nitrogen oxides.

Conserving Energy

The Administration estimates that the Btu tax "will reduce projected growth in energy consumption by over 7 percent." By the year 2000, the tax is expected to reduce oil imports by more than 400,000 barrels a day. These savings can only be achieved by slowing the rate of increase in vehicle miles travelled (VMT), because transportation uses 63% of our oil and is the only sector of the economy where oil consumption is still rising. In recent years, oil imports have accounted for as much as two-thirds of our trade deficit, and if current trends continue oil will cause the trade deficit to expand by billions of dollars more.

This makes it all the more important to encourage transit use as an alternative to single-occupant vehicle driving, which consumes more energy per capita than any other form of transportation. One person taking transit to work for a year instead of driving alone saves 200 gallons of gasoline, and a 10% increase in transit use nationwide would save 135 million gallons of gasoline each year.

Protecting Low-Income Americans

We believe that low- and moderate-income individuals should be protected from the impacts of the Btu tax. The Administration stresses that the impact on low- and moderate-income families would be offset by other proposals, including expansion of the earned income tax credit, increased funding for the Low Income Home Energy Assistance Program (LIHEAP) and more funding for Food Stamps.

Any increase in transit costs would penalize the most vulnerable members of our society, including people who depend on transit because their incomes are so limited. People in these income categories are more dependent on transit than the population as a whole. On a nationwide basis, 27.5% of transit riders have incomes below \$15,000. In contrast, 14.2% of the total population is under the \$13,924 poverty line for a family of four. Twelve million families had no motor vehicle while another 31 million had just one vehicle. For many people in these households, transit is the only transportation option.

Since transit fares increased by 32% in real terms during the 1980s, we believe that low-income people who depend on transit have already sacrificed enough. We hope you will ensure the energy tax policy protects them.

Exempting Transit from the Btu Tax

According to the Administration, the Btu tax is more likely than any alternative revenue measure to advance a combination of policy goals — raising revenue, saving energy, reducing pollution. We ask you to remember that increased use of transit is more likely than any alternative to advance a wide range of policy goals — protecting the environment, saving energy, limiting traffic congestion, providing accessible transportation to transit-dependent people, and making our transportation system more efficient movement.

Because transit provides these benefits, we urge you to shield it from any adverse impacts of the Btu tax. The most straightforward option would be to exempt transit from the tax on the grounds that transit use is an environmentally beneficial form of conservation. The tax would not apply to nonconventional fuels (solar, wind, geothermal, biomass, municipal solid waste, and tires burned as fuel) or to oxygenates (ethanol, methanol, ETBE, and MTBE). As the Administration notes, "all of the oxygenates, when mixed with gasoline, promote cleaner burning and reduce our dependence on foreign oil." Transit use goes one better: The fuel in a transit rider's car doesn't burn at all.

The loss of revenue from exempting transit would be minuscule. The Btu tax is estimated to raise \$1.95 billion in FY 1994, of which transit accounts for only \$29 million. Total revenue will reach \$22 billion in FY 1997, with transit accounting for less than \$100 million.

It may be argued that transit should not be exempt because everyone should pay a share of this tax. We believe that transit-dependent riders with limited incomes have already paid enough. But what about people who choose transit even though they have the option of driving their own vehicles? The Btu tax is supposed to encourage people to use forms of transportation, such as transit, that conserve energy and reduce vehicle emissions. At 7.5 cents per gallon of gas, the tax can fairly be called a gentle nudge toward conservation and clean air. That makes it all the more important to ensure that the tax does not increase the costs of transit and thereby discourage some individuals from choosing transit.

Increasing Operating Assistance

If it is not feasible to exempt transit from the Btu tax, another option would be to increase federal operating assistance. Operating assistance in FY 1993 is \$802.3 million, much less than the authorized level of \$1.03 billion. Current formula apportionments to smaller urbanized areas in 24 states are insufficient to fund their operating limits. Operating aid to rural transit operators was reduced by over 14%. The outlook for FY 1994 is no better. The Administration has proposed to freeze operating assistance at \$802.3 million.

ISTEA provided, for the first time in 10 years, a mechanism to increase federal operating assistance each year to reflect transit's increased cost of doing business. With every year and every new federal mandate, it becomes more urgent to make the full amount of this funding available.

We applaud the Administration's efforts to reduce U.S. dependence on imported oil and limit vehicle emissions. Transit's chief contribution to each of these goals is to provide an alternative to the single-occupant vehicle, the mode of transportation that causes the lion's share of the problem. Any federal policy that makes transit less competitive will be counterproductive. If increased transit operating costs due to the Btu tax are passed on to customers -- whether as higher fares or service reductions -- it will hinder the transit industry's ability to increase ridership and thereby save energy and reduce air pollution. We look to your Committee to prevent this unintended negative consequence of the Btu tax from occurring.

Transit and National Goals

Increased transit ridership is a prerequisite for successful implementation of the Intermodal Surface Transportation Efficiency Act (ISTEA), the Americans with Disabilities Act (ADA), the Clean Air Act Amendments of 1990, and the comprehensive energy bill of 1992. It is still very much an open question whether these laws can accomplish their ambitious goals.

ISTEA reversed a decade of steadily declining federal support for transit. Congress must now provide full funding of the ISTEA authorized transit program -- \$5.1 billion per year in FY 1994-96 and \$7.3 billion in 1997. Even with full funding, federal transit funding will remain well below 1981 appropriations levels in real terms.

ISTEA also changes the institutional mechanisms for determining transportation policy. We believe that President Clinton and Transportation Secretary Peña are committed to the institutional transformation envisioned in ISTEA. We hope you will endeavor to ensure that the tax system encourages this process.

The promises of money have not yet been entirely fulfilled. The President's stimulus package, as originally proposed, would close half the gap between FY 1993 appropriated and authorized transit funding -- yet it is stalled and the transit funding may be reduced. The FY 1994 budget proposal includes 87% of the authorized transit spending, compared to full funding for the highway programs authorized in ISTEA.

Meanwhile, the bills for costly mandates are steadily coming due. Expanded paratransit service, capital investments for accessible vehicles and facilities, purchase of clean fuel vehicles, and other expenditures are creating new pressure on transit agency budgets. APTA's comprehensive survey of transit capital needs, conducted in 1990, identified overall capital requirements of \$90.8 billion during the 1992-1997 period. The General Accounting Office recently testified to the Senate Transportation Appropriations Subcommittee that the \$90.8 billion figure is probably understated because it does not fully account for:

- "(1) costs for transit vehicles to convert to alternative fuels, due to clean air or energy conservation requirements; (2) ADA requirements to make existing transit stations accessible to persons with disabilities and to provide expanded special services for the disabled; and (3) expanded transit services to meet specific transportation-related

goals, such as reduced traffic congestion or improved air quality." [*Mass Transit: FTA's Projections Could Better Reflect State and Local Needs*, March 11, 1993.]

Now that transit systems have developed cost estimates for paratransit service and ADA-related capital investments, APTA hopes to develop a more accurate estimate of these costs. We believe that annual, nationwide costs will be three or four times greater than the \$938 million per year estimated by DOT in 1991. The Clean Air Act requires reduced emissions for many transit vehicles, and additional alternative fuel requirements were included in last year's energy legislation. The annual cost to install exhaust cleaners and upgrade fuel is \$110 million. One nationwide survey found that installation of particulate traps on the U.S. bus fleet would cost an estimated \$522 million. Although final rules have not been issued, federal drug and alcohol testing requirements are expected to cost transit agencies millions of additional dollars. We hope that Congress and the Administration recognize the importance of helping our industry with these expenses.

We believe that everyone should have access to modern, efficient transit systems that reduce air pollution and congestion by attracting new riders and getting them out of their automobiles. Without adequate federal support, the reality is that transit-dependent people -- including many low-income workers, senior citizens, and people with disabilities -- will be consigned to shabby, inefficient transit systems. People who have a choice will use their own vehicles regardless of the consequences for pollution, congestion, and wasted energy.

The Federal Gasoline Tax

APTA strongly favors extending the 2.5 cents per gallon federal excise tax on gasoline that is due to expire at the end of September 1995. We believe that this tax, now used for deficit reduction, should be dedicated to transportation and deposited in the Highway Trust Fund (HTF). At least 20% of this tax, or one half cent per gallon, should be designated for the Mass Transit Account (MTA) of the Highway Trust Fund.

We are very pleased that Transportation Secretary Peña has proposed to extend the 2.5 cents gasoline tax and dedicate it to the Highway Trust Fund with an 80/20 split between the Highway Account and the Mass Transit Account -- two cents for the Highway Account and one half cent for the Mass Transit Account.

We applaud Secretary Peña's decision to give the Mass Transit Account 20 percent of the revenue from the 2.5 cents because it upholds a longstanding precedent. In 1983 and again in 1990, the Mass Transit Account received 20 percent of the increase in gas taxes designated for the Highway Trust Fund. In 1991, Congress reaffirmed the 20 percent minimum when extending the 1983 and 1990 tax increases in Title VIII of ISTEA.

Secretary Peña's proposal sends a strong message of federal support for transit and other high-occupancy modes of travel that are essential to clean up the air, reduce energy use, control traffic gridlock, rebuild our cities, and meet the mobility needs of all Americans. This is especially valuable right now, since local areas are developing comprehensive, long-term transportation plans that comply with Clean Air Act and ISTEA requirements.

In addition, the Mass Transit Account needs the revenue from the extra one half cent. APTA estimates that, without additional revenue, the Mass Transit Account's committed balance will exceed its cash balance in FY 1998. This estimate assumes full funding of the part of the ISTEA transit program that is funded from the Mass Transit Account, a very reasonable assumption given recent funding history. In FY 1993, nearly 96% of funds authorized from the MTA were appropriated. Overall transit funding was \$1.6 billion below the authorized amount, but not because MTA appropriations fell short of the authorized level. Only 37% of the transit program's General Fund authorization was appropriated, and that accounts for virtually all of the shortfall.

An additional source of intense pressure to appropriate the entire authorized MTA funding level will be the growing need for Section 3 Discretionary New Start funding for major capital projects. ISTEA specifically authorizes 48 New Start projects in 23 states, with total federal funding of \$6.112 billion. So far, \$1.152 billion has been appropriated for these earmarks, leaving a \$4.96 billion New Start funding requirement in FY 1994 through FY 1997. As work on these projects goes forward, and new ones are proposed, the demand for New Start funding has nowhere to go but up. To the extent that these major capital projects continue to have support in Congress, there will continue to be pressure for MTA appropriations to reach the full authorized level.

As Congress plans for the years after the end of the ISTEA authorization period in FY 1997, we hope that Congress will address future revenue requirements of both the Mass Transit Account and the Highway Account in a fair and equitable way.

Commuter Rail Diesel Tax Exemption

Traditionally transit systems have been exempted from paying federal excise taxes on fuel. APTA supports legislation to exempt commuter railroads from the 2.5 cent per gallon excise tax on diesel fuel passed in 1990. That year's budget reconciliation act exempted other transit systems from this tax, but, in what APTA believes was an oversight, commuter railroads were required to pay the tax.

Congress last year passed legislation to correct this mistake as part of a tax bill vetoed by President Bush. APTA favors the passage of legislation to exempt commuter rail operators from this tax. Any new taxes are passed on in the form of higher fares, which act as a barrier to increased ridership.

Transit Pass

Mr. Chairman, we want to thank you and the Committee once again for your leadership in enacting the transit pass provision of the Comprehensive National Energy Policy Act of 1992. This law provides that, as of January 1, 1993, employers can provide employees up to \$60 per month in transit benefits -- nearly triple the \$21 per month that was previously allowed -- or a \$60 per month benefit for employees who commute in commuter highway vehicles such as vanpools and commuter buses. The new law also caps nontaxable employer-paid parking at \$155 per month, so that parking benefits in excess of that amount must be counted as income to the employee.

This is good public policy because it extends a benefit to people who depend on transit, many of them lower-income workers, and it begins to reward those who choose to use transit and thereby do their part to clean up polluted air, save energy, and reduce traffic congestion.

This law has excited a great deal of interest all across the nation, and APTA has received hundreds of inquiries about the new transit pass benefit. We are working with the Association for Commuter Transportation (ACT) and the Federal Transit Administration to ensure that the transit pass reform law is successfully implemented. Our goal is to educate employers and commuters about the new law, to provide technical assistance to transit agencies and employers, and to disseminate information about successful local transit pass programs. Because increased use of transit and carpooling will be more and more important in areas with air pollution problems, we hope to focus attention on the urbanized areas with the most serious non-attainment problems, including the New York, Chicago, Los Angeles, Houston, and Philadelphia metropolitan areas.

One possible refinement of the law would be to require the inclusion of transit pass and vanpool benefits in "cafeteria benefit" programs offered by employers. We hope to work with the Committee on this and other ways to ensure that the transit pass law fulfills its promise.

We also want to alert you to one possible issue that may arise as the Internal Revenue Service develops regulations pertaining to this law. We believe that Congress intended this proposal to encourage people to use all forms of transit, including driving to park-and-ride lots at bus and rail terminals.

To encourage park-and-ride commuting, employers may wish to provide an employee with up to \$60 per month in transit pass benefits and up to \$155 per month in parking benefits. We hope that the IRS regulations will recognize that Congress intended to encourage park-and-ride commuting as well as other forms of transit and shared-ride services.

Setting Transportation Prices Fairly

The transit pass reform law is a significant first step toward equitable treatment of transit riders and drivers of single-occupant vehicles. Other government policies, however, continue to subsidize single-occupant vehicles.

Two years ago, Mr. Chairman, you described many of the problems caused by the way we Americans set transportation prices in the introductory statement to Senate Report 102-71, on S. 1204. One effect is to inhibit the use of transit, but society and the economy pay many other costs. As you pointed out, congestion increases with no end in sight because space on our highways is perceived as a free good; auto-induced sprawl raises the tax bills for more roads, utilities, sewers, and other infrastructure costs of new development and other environmental and energy consequences have already been noted.

The World Resources Institute has estimated that drivers pay for only about 13 percent of the public costs of highway transportation -- we all pay the remaining 87 percent in our tax and medical bills, in inconvenience, and in diminished quality of life, but without any label showing that highway travel costs are responsible. The U.S. has by far the lowest gas tax rate of any Western industrial economy. The average rate for Japan and five European industrial countries is six times ours. Little wonder, then, that per capita fuel consumption is three to four times greater in the U.S. than in other nations.

We in transit believe that your Committee should seriously consider increases in the federal gasoline tax to levels that reflect the high hidden costs of gasoline consumption, as a way to increase the efficiency of our transportation system. A gas tax increase, with all or part of the revenues dedicated to transportation purposes, would reduce the trade deficit and promote conservation and cleaner air by discouraging drive-alone commuting. It would reinforce ISTEA's mechanisms for encouraging local flexibility and competition.

Conclusion

Mr. Chairman and members of the Committee, your decisions on these tax issues can make the difference between stagnation for the U.S. transit industry or a new era in which transit increases its ridership by providing a modern, efficient alternative to single-occupant vehicle commuting. We ask for your support so we can do our part in improving productivity, providing all Americans with accessible transportation, creating jobs, cleaning up polluted air, reducing dependence on imported oil, and protecting the quality of life in urban, suburban, and rural communities throughout the nation.

PREPARED STATEMENT OF SENATOR MAX BAUCUS

I appreciate you calling this hearing today, giving us the opportunity to discuss the broad-based energy tax proposal with the distinguished Secretary of the Treasury, and former Chairman of this Committee, Lloyd Bentsen. Welcome Back Mr. Secretary.

As I stated in the Secretary's last appearance before this Committee, I commend the President for compiling an economic package that seriously addresses three of the most important issues facing this nation: The deficit, jobs, and long-term capital investment. I am committed to working with you, Mr. Secretary, and the rest of the President's team to see that long-term economic growth and deficit reduction become a reality.

I respect the Administration's decision to choose the BTU tax as the revenue-raising proposal most likely to achieve a mixture of policy goals ranging from energy conservation to enhanced national security. However, over the longer term, more significant steps will be needed to encourage corporations and individuals to save and invest more and at the same time borrow less. Specifically, this means that a new tax, based on consumption, will have to be enacted along with relief from the income tax for working class Americans and corporations.

I am encouraged by the Administration's willingness to assure that the impact of the proposed BTU tax is fair from a geographic and an industry perspective. This commitment to fairness is clearly shown by the modified version of the proposal that shifts the collection point of the tax and repeals the supplemental tax on home heating oil.

The proposed BTU tax also places a heavy burden on the U.S. agriculture. Farmers would get hit by the tax in all phases of their work. They would pay the tax on the energy used for irrigation and operation of equipment, on the raw materials of food production such as fertilizer and crop protection chemicals, and on the transportation required to get products to market.

There are other legitimate problems that must be addressed, if the BTU tax is to become law. For example, I remain concerned about the effect of the energy tax on the international competitiveness of energy-intensive industries, such as aluminum. The U.S. aluminum industry would not be able to pass on the cost of the tax to consumers because prices are determined by the international marketplace. As a result, imposition of the tax may result in the loss of jobs in Montana and numerous other states.

Finally, it may be necessary to consider further technical refinements to the tax in order to insure that it fully satisfies both its environmental and fairness objectives. I look forward to working closely with the Administration to enable this and other components of the economic package to move toward completion.

Thank you.

PREPARED STATEMENT OF VICTOR G. BEGHINI

This statement regarding the Administration's energy tax proposal is submitted on behalf of the American Petroleum Institute (API). API represents approximately 300 companies involved in all aspects of the oil and gas industry, including exploration, production, transportation, refining and marketing.

API POLICY

API has long supported the notion that growing federal deficits sap the vigor of the American economy by crowding out productive private sector investment, and we applaud the President's efforts to take serious steps to reverse this process, especially the spending reductions that are included in the package. Spending growth, not reduced revenues, is the primary cause of the current deficit. Federal spending, at nearly 24% of national income, is the largest drain on the private economy. Since the mid-1960's, federal revenue as a percent of GDP has remained relatively constant at 18-19%. On the other hand, federal spending as a percent of GDP has grown over the same period from 17.6% to 23.5% in 1992.

We also agree that the individual elements of the President's plan should not be assessed in isolation, but rather in terms of their effects on achieving the goal of the overall plan, namely to enhance future prospects for U.S. economic growth. It is on those grounds that we oppose inclusion of the Btu tax in the plan. The Btu tax distorts energy markets; increases the costs of all U.S. goods; makes U.S. products less competitive in world markets; imposes the added burden of administrative complexity; and, creates highly inequitable results across income groups and across regions of this country. Moreover, it works at cross purposes to other key elements of the President's program, and substantially diminishes the prospects that the program will enhance U.S. economic growth.

If, after all appropriate spending reductions have been achieved, additional revenues are required, we believe that a broad-based credit invoice Value Added Tax is the preferable alternative. It has few of the adverse effects of the Btu tax, and would, instead, reinforce the elements of the President's package intended to restore vigorous long term growth to the U.S. economy.

THE BTU TAX - ECONOMIC EFFECTS

If passed on fully to consumers, the Btu tax will raise the cost of fuel consumed in the United States by about \$31 billion per year by the time it is fully phased in in 1997. Moreover, because of the higher tax on oil, revenues derived from petroleum products will constitute a disproportionate share of the total. While petroleum consumption is expected to account for only about 39% of Btus consumed in 1997, it will account for about 60% of revenues from the tax.

The Btu tax will raise consumer prices of virtually all energy in the United States. But, contrary to Administration goals, the burden of these increases will not be spread fairly across income classes, regions or industries.

The tax will be borne overwhelmingly by the middle class. Across regions of the country there are also wide disparities in the patterns of energy consumption. Hence, some regions will pay far more in direct and indirect costs than others. Because the tax on oil is more than twice that of other energy sources, workers and consumers in states that rely heavily on oil--for consumer and industrial use--will be especially hard hit.

One of the principal factors affecting these regional variations is the wide diversity of energy use patterns by industry. Petrochemical, aluminum, and many other types of manufacturing inherently require substantial amounts of energy to produce their products, while other industries such as services, require less. The tax thus singles out U.S. manufacturing and certain other sectors (such as transportation, e.g. airlines, rail, etc.) to bear the heaviest burden of the tax.

These discriminatory impacts are particularly a problem for those firms producing goods to compete in world markets. Petrochemicals and aircraft manufacturing are two such industries, but there are many others who will be unable to pass through the tax on the world market. It has been argued by some that U.S. energy costs are so low by world standards that this tax won't affect our competitiveness. This is simply wrong. In particular, if we look at industrial energy costs for our North American trading partners, Mexico and Canada, energy prices in the U.S. for industrial use are generally as high or typically higher already. The cost of fuel oil for industrial use, for instance, is about identical between the U.S. and Canada, but higher than Mexico. Natural gas in industrial use is slightly more costly in the U.S. than in Canada, and far more costly than in Mexico. Moreover, these are important, growing markets for the U.S. Intra-North American trade by 1991 had become a larger share of U.S. trade than that with either Europe or Japan, and with passage of NAFTA will expand further in the future. It is a risky environment in which to propose a tax that will make U.S. industrial energy costs unambiguously the highest in North America, which this tax does.

API has asked DRI-McGraw Hill, a noted international economic consulting group, to examine the effects of the President's package, both on energy markets and on the U.S. economy. The DRI results show that the Btu tax by 1998 (less than 1 year after its full implementation) will result in a loss of GDP of nearly \$34 billion annually in 1993 dollars, resulting in a loss of about 400,000 jobs. This will cause other government revenues tied to economic activity to be lower, and expenditures tied to economic activity (such as unemployment compensation) to be higher, than they would be without the Btu tax. These effects offset about 40% of the direct revenues raised by the tax. As a consequence, while the tax raises over \$31 billion annually by 1998, the deficit falls by only \$19 billion. If the administration attempts to offset these negative effects with other direct spending (such as the proposed \$10 billion increase in Low Income Home Energy Assistance Program, food stamps, and the Earned Income Tax Credit), the net effect on the deficit could be far lower.

Second, the DRI results suggest that the tax seriously increases the inevitable short run costs that will need to be incurred to secure the deficit reduction the President is seeking by 1998, and in the process significantly compromises the President's goal of enhancing the long run growth potential of the U.S. economy.

Over the 1993 to 1998 period covered by the President's program, the DRI analysis shows that serious deficit reduction efforts such as those proposed will actually dampen the level of U.S. economic activity and cost jobs. Such costs are transitional, and may be an unavoidable cost of reorienting the economy from consumption to investment. DRI estimates that the program as a whole will reduce the deficit by \$117 billion, at a cost of between 500 thousand and 800 thousand jobs by 1998. The benefits of this deficit reduction lie beyond the horizon of the President's proposal. This does not suggest that the President's program is not worth pursuing, since a \$117 billion deficit reduction is a sizeable achievement with significant long term benefits. It does suggest, however, that the short run cost of this achievement is likely to be sizeable, and certainly that it

cannot be ignored. Particularly, we cannot afford to neglect available revenue alternatives that could achieve the same deficit reduction at substantially lower cost. Our opposition to the Btu tax stems in part from the fact that other revenue alternatives are available to achieve the same level of deficit reduction at substantially lower short term cost than that associated with the Btu tax. Of the 800 thousand jobs lost by 1998 in the DRI study, nearly 400 thousand, or about half, were directly attributable to the effect of the Btu tax. Moreover, the DRI results show that these short run losses could be substantially reduced by the substitution of a broad based Value Added Tax of equal yield. As a consequence, the Btu tax unnecessarily raises the short run cost of achieving the President's deficit reduction goals.

Perhaps even more importantly, the Btu tax compromises the effectiveness of any given level of deficit reduction in enhancing U.S. economic growth over the long term. The tax permanently raises U.S. production costs, sacrificing U.S. productivity and making the U.S. less competitive in world markets. By contrast, a VAT taxes only consumption, not production, preserving U.S. competitiveness and providing an incentive to private savings which reinforces rather than offsets the effect of deficit reduction.

The Administration argues that the tax will improve our energy security by reducing our dependence on foreign oil. It will reduce oil consumption, by Administration estimates, by about 400,000 barrels per day by the year 2000. If correct, this will decrease U.S. import dependence in the year 2000 by a trivial amount (from about 56% to about 55% of total consumption). However, the tax is also likely to decrease the supply of domestic crude oil and products by an amount sufficient to offset much, if not all, of the expected consumption decline. Fuel and related costs account for between 25% and 40% of oil and gas production costs even at sites using conventional production technology. Btu tax cost increases could reduce oil and gas production from conventional sources by from 20,000 to 100,000 barrels of oil equivalent per day by the year 2000.

Finally, even if imports were to fall by the full 400,000 barrels a day claimed by the Administration, the cost of \$34 billion in lost GDP is excessive relative to other alternatives for improving energy security. Using the Administration's optimistic predictions of import reductions, the cost of the Btu tax works out to about \$230 per barrel. By contrast, oil can be purchased for the SPR at a cost of about \$20 per barrel, which contributes in a direct and tangible way to U.S. capabilities to respond to any such future interruption. Taking steps to strengthen domestic petroleum production such as opening federal land and offshore areas would provide a means to increase energy security that would enhance U.S. economic performance, not detract from it. Given these alternatives, it is implausible that any small reductions in oil imports attributable to the Btu tax represent a cost effective way to address U.S. energy security concerns.

The Administration argues that the tax represents a desirable way to reduce emissions from the burning of fossil fuels. Granted, the tax will reduce consumption of energy slightly, but even the Environmental Protection Agency forecasts these effects to be minimal, amounting to about a 0.8% decline in nitrogen oxides and a 0.25% decline in hydrocarbons and carbon monoxide. Moreover, sulphur dioxide emissions, associated with acid rain, could actually increase since the tax encourages a shift from low sulphur fuel oil to high sulphur fuel oil. Low sulphur fuel oil, which requires additional refinery processing, will be more expensive to produce and, therefore, will be priced higher in the market (estimates vary from 2 to 7 cents per gallon). While EPA regulations require on-road diesel to be low-sulphur (effective

October 1, 1993), other fuel oil users are free to purchase either high or low sulphur fuel for heating or other off-road uses. Since the proposed Btu tax does not recognize the environmental benefits of using low sulphur fuel oil for heating and other off-road purposes, continued extensive use of high sulphur fuel oil can be anticipated.

In fact, there are far more effective ways to deal with these various emissions than a broad based energy tax. The emissions reductions expected under the Clean Air Act Amendments of 1990 require far more significant, and more targeted reductions. For example, the CAA amendments of 1990 are expected to result in reductions of 15% in hydrocarbon emissions in smog-prone areas, about 17% in nitrogen oxides, and 45% in total sulfur dioxide emissions by the year 2000. By comparison, any environmental benefits associated with the Btu tax are at best small and relatively expensive.

In summary, the Btu tax as currently proposed represents poor tax policy. It offsets rather than reinforces the beneficial effects of deficit reduction. It raises U.S. production costs, making all U.S. products less competitive in world markets. It costs jobs, and reduces GDP by more than the revenues raised by the tax. As a consequence, it seriously damages the effectiveness of the President's program in promoting economic growth.

THE BTU TAX-DESIGN ISSUES

Since the Administration first published its proposal in February, it has made a number of design modifications. Nevertheless, the tax would still create inequities in the domestic energy market, disadvantage U.S. products vis-a-vis international competition, and create burdensome compliance and administration problems. API has identified the following issues with regard to the design of the tax.

Petroleum Surtax

The most onerous aspect of the tax for the petroleum industry and its customers is that the rate for petroleum products is $2 \frac{1}{3}$ times that of the rate on competing fuels. Where our products--for example, resid, heavy oil and petroleum coke--compete directly with natural gas and coal, refiners will either never fully recover the tax or will lose market share to the competing fuels. The surtax, in combination with imposition of the tax at the refinery gate, will result in increased gasoline and other light end imports. This will drive more refining offshore, with consequent job loss and greater product imports. For an industry that has lost 450,000 jobs over the past decade and is spending billions of dollars annually to comply with new environmental mandates, this additional blow is unconscionable.

Point of Collection

The point of collection of the tax should be at the terminal rack, or when the product "breaks bulk." Imposing the tax at the refinery gate, as the Administration proposes, creates major problems for administering exemptions for petrochemical feedstocks and other non-fuel uses, fuel exports, and the reduced rate for home heating oil. This is because the end use of many petroleum products is not known until very far down the distribution chain.

If the tax is generally imposed at the refinery gate, one of three methods will have to be applied to exemptions for dual use products: 1) all products would be sold tax-included with the final consumer of the exempt use applying for a refund. This would impose the carrying cost of the tax and cash flow problems on those persons entitled to the exemption and create massive

refund claims for the IRS to administer; 2) all dual use products (blendstocks, feedstocks, e.g.) would leave the refinery untaxed with a use tax imposed on the person using them for a taxable purpose; or, 3) a complex and cumbersome system of exemption certificates would be developed. Either of these latter two methods creates opportunities for tax evasion. Whichever exemption method were chosen, an expensive audit system would be required to ensure proper compliance.

Refinery gate imposition also creates competitive distortions between domestic refiners and blenders. NGL blendstocks such as butane and natural gasoline are taxable at the natural gas rate when they leave a refinery or gas plant. If blended with finished gasoline downstream at a terminal or bulk plant, the NGL blendstocks will bear the lower rate. If, on the other hand, they are blended with gasoline at the refinery, the total volume of other finished product will be taxed at the gasoline rate. A blender could have a significant tax advantage over refinery produced products. Similar problems arise with regard to the exemptions for oxygenates which can also be blended at terminals or bulk plants. It must be clear that the blending of non-taxed or low taxed components to produce a fuel must be taxed at the same rate as refinery produced fuel.

Finally, imposing the tax at the refinery creates market distortions between imported and domestically refined product because of the difference in transit time between tax point and market and the resulting difference in carrying cost of the tax.

The terminal rack--where most federal gasoline tax is currently collected--is the tax point that creates the least market distortions, provides most easily for administration of exemptions, and offers reduced implementation costs for both taxpayers and the IRS because it can piggyback on an existing collection system.

Energy Content of Manufactured Goods

A major problem with the tax is the increased energy cost embedded in manufactured goods which makes them less competitive with foreign manufactured goods in both domestic and foreign markets. Retaining U.S. industries' competitive position in world markets would require some method of imposing the energy tax on imported products and rebating it on exports. The difficulty of designing and administering such a system, however, is mind boggling. Also, it may not be possible under international trade agreements. It is our understanding that the General Agreement on Tariffs and Trade (GATT) prohibits imports from being taxed at a higher rate than like domestic products.

The problem of increased energy cost embedded in manufactured goods is exacerbated when the energy used by manufacturers of taxable energy is also taxed. For example, in the process of producing and refining oil and natural gas that will ultimately be subject to the BTU tax, the petroleum industry uses large volumes of energy. Taxing energy used to produce oil or natural gas, and other taxable energy, would unfairly impose an additional increase in the embedded energy cost of manufactured products.

Competition with Imported Energy

The Btu tax also makes domestically manufactured energy less competitive with imported energy. Petroleum production and refining is one of the most energy intensive manufacturing processes. If domestically produced petroleum and petroleum products are forced to carry the embedded cost of the BTU tax while imported products do not, domestic refiners will be at a further disadvantage. This would jeopardize further refining capacity in this country and promote the importation of petroleum products--exactly the opposite of the President's stated intention.

The Administration has obviously recognized the serious economic burden when "fuel used to produce fuel" is taxed because the revised version of their proposal provides several exemptions in this regard. However, a number of issues remain unresolved. For example, crude oil used in a refinery is exempt but not other fuels used in a refinery; natural gas used in enhanced oil recovery (EOR) projects for heavy oil is exempt, but not natural gas used in other EOR projects; crude oil or natural gas used "on the premises where it is extracted" is exempt, but not purchased crude oil or natural gas. Each of these narrowly drawn exemptions, while a start in the right direction, creates additional distortions. All energy used in the production and manufacture of taxable energy should be exempt.

Hidden Tax Increase - GDP Deflator

The Administration proposes to index the Btu tax to the Implicit Price Deflator, a measure which bears no relationship whatsoever to the value of the energy commodity.

Indexing the tax will lead to a substantial erosion of real income in the oil and gas industry. Over the last ten years, the price of crude oil has fallen over 44 percent while the general price level, as measured by the Implicit Price Deflator, has increased by over 44 percent. If the Btu tax on crude oil had been in effect at the beginning of the period, tax collection from the industry would have increased by \$9.7 billion at a time when industry profits were depressed and 450,000 jobs were lost.

The Btu tax will lead to a substantial erosion of real income and cause the loss of thousands of additional jobs in the oil and gas industry unless some provision is made to limit the effects of increasing taxes during periods when product prices fail to keep up with inflation.

Floor Stocks Tax

While a floor stocks tax is a typical feature of an excise tax, the typical excise tax does not contemplate annual changes in the rate. Annual floor stocks taxes triggered by the indexing mechanism will not only exacerbate the harmful effects of indexing but also will create a significant administrative burden. There should be no automatic floor stocks taxes after the tax is fully phased in.

Other Issues

It must be remembered that there is currently no federal mechanism for the taxation of natural gas. Additionally, there are no federal mechanisms for taxing petroleum products at the refinery gate or coal by the recipient. API believes that the time allotted for implementation of the tax is overly optimistic, given the number of details which must be resolved. For example, who will be the taxpayer of natural gas liquids at a processing plant if the plant owner does not own the gas being processed, or any of the end products? It is also unclear what is meant by the terms "premises", "refinery", "crude oil", "fuel", "enhanced oil recovery", "heavy oil", "pipeline", "coal seam methane", etc.

Another inequity which has not been addressed is the imposition of the petroleum surtax on petroleum coke. In view of the fact that the principal competing fuel of petroleum coke is coal, petroleum coke should be treated, for the purposes of the tax, as coal. Petroleum coke used as anodes should be exempt from the tax.

CREDIT-INVOICE VALUE ADDED TAX

API's position is that, since the budget deficit is driven by expenditure growth, Congress and the President should focus on

spending reductions. Taxes should not be increased first. If, after all spending reductions are implemented, Congress eventually concludes that there should be significant additional taxes, any new taxes should: 1) avoid penalizing U.S. manufacturing in domestic and foreign markets; 2) be neutral with respect to economic decision-making by businesses and consumers; 3) not be overly regressive or progressive; and 4) avoid negative impacts on incentives to save and invest. The API believes that only a credit-invoice style value added tax (VAT) satisfies these criteria, would have the least harmful effect on the economy, and would be the fairest and most equitable way to raise revenues.

Under a credit method VAT, each firm's tax liability would equal the tax on its sales minus the tax that the firm paid on its purchases of capital goods as well as raw materials. Thus, a VAT does not discriminate against capital as does an income tax. A VAT avoids the numerous distortions that an income tax produces in decision-making throughout the economy: in choices of methods of finance; in choices of form of doing business; in choices of production and technology; and in choices among consumption goods.

Furthermore, it is widely agreed that capital investment in the U.S. should be increased. Thus, it is preferable that any new tax should fall on consumption rather than discourage savings and investment. A VAT meets this objective.

A VAT does not harm U.S. competitiveness in world markets. U.S. manufactured goods are not burdened with a VAT when they are exported, and imports must bear the same tax as comparable domestic goods for sale in this country. A VAT does not interfere with the consumer's decisions about what goods or services to consume since relative prices are not changed. And, a VAT does not have the regional distortions that many energy taxes (such as a Btu tax or a gasoline tax) have and does not fall on but one industry or product.

The credit-invoice VAT--under which the tax is separately stated on each invoice and each business gets a credit for the tax that it paid on its purchases--encourages compliance, effectively accommodates exemptions and a multi-rate tax, facilitates border tax adjustments, does not become a cost of doing business, potentially captures taxes from activities that currently avoid the income tax and places the incidence of the tax on the non-business consumer. Thus, the credit mechanism is superior to other methods of calculating the VAT.

The major arguments against a VAT are that it is regressive, would tempt Congress to expand federal spending, and would be costly and burdensome to implement. A credit invoice VAT can easily accommodate the regressivity concerns by using zero rates for basic goods and services such as food and medicine. In addition, the regressivity of a VAT can be offset by changes in either the income tax (e.g., the earned income tax credit) or government transfer programs. Historical data show that VATs do not add to government spending or to total tax burdens that would occur anyway. A study published in the National Tax Journal found that the VAT did not increase the share of GDP going to taxes among countries belonging to the OECD. Growth rates in tax burdens did not significantly differ between non-VAT and VAT countries. While there will be start-up costs with a VAT--as with any new tax--the European experience has shown it to be a more efficient revenue collector than income taxes.

PREPARED STATEMENT OF SECRETARY LLOYD BENTSEN

Chairman Moynihan, members of the committee, I want to thank you for asking me to come up and discuss the specifics of our energy tax proposal with you.

Let me say from the outset that no one likes to raise a tax, but there are times when you have to do it. I'm pushing this hard because of its significance to our long term economic health. As a nation we need this. Frankly, it's long overdue.

This energy tax is an important part of our overall plan to reduce the deficit, create the conditions to restore long term growth to our economy, and create the jobs and income growth Americans want. It also reflects the very clear understanding in the Clinton Administration that we cannot let the status quo continue. We must take bold steps to control our economy.

We cannot view the energy tax in isolation. Let me tell you why. These deficits that we've been running up so rapidly for over a decade now have been draining the pool of private savings. They have been cutting the rate of capital formation by our industries. They have caused us to borrow from abroad. The net result has been a slowdown in the rates of growth of productivity and in the real income of American workers. In the process, we've become the world's leading debtor nation.

That's why the energy tax is important to us -- to help us get the deficit headed down. Between 1994, when we get the first elements in place, and 1998, when it will have been fully functioning for a year, this tax will produce over \$72 billion dollars in revenues. That's a significant contribution. In fact, it's one-sixth of the total net deficit reduction in our plan for the years 1994 through 1998. The first year this tax is fully phased in, 1997, it will produce over \$22 billion in revenues. That amount will grow over time.

This program has won widespread support throughout America. But I know that not everyone in the energy business agrees with us that we need this energy tax. Take the American Petroleum Institute for instance. It is composed of some of the world's largest oil companies, and they have most of their reserves and a good deal of production overseas. Their opposition is understandable, since our program will reduce oil imports.

I am gratified, however, that some of the members of the API -- like Arco and Shell -- agree that what we're trying to do for the country is worthwhile. Not only have those firms endorsed our program, but we've also gotten the support of a broad spectrum of the energy business, from the smaller independent oil and gas producers, all the way up to electric utilities.

Now, let me make a few broad points about the energy tax, and then get into some of the specifics.

First, this program is fair. It is fair economically. It is fair geographically. You can see that from my first chart. And, rather than singling out any particular fuel, we went after the Btu content of all our fuels and energy sources.

Secondly, we should look at what this tax accomplishes, and what it will cost American families.

Obviously, it is a vehicle for deficit reduction. But at the same time we're encouraging a shift toward cleaner fuels, reducing pollution, encouraging conservation and cutting back on our imports of oil by an estimated 400,000 barrels a day. Let me put that number in perspective for you: over a year's time,

that's about the energy equivalent of the amount of gasoline it would take to drive every automobile in the United States 1,000 miles.

Conserving energy, reducing pollution, cutting energy imports, and reducing our deficit are significant accomplishments. You should also remember that as we reduce the deficit, we lower interest rates, raise investment and increase long run productivity and growth.

This tax, contrary to what some might argue, will not be a drag on our ability to compete in world markets. That's just not so. You can see on this second chart that we estimate that on average, manufacturing production costs will rise just one tenth of one percent because of this tax.

It will be more costly in a few industries, such as those which are very energy intensive. But if we'd exempted them, it would have required higher taxes on other energy users, and it would have undermined our objectives of increasing energy efficiency and increasing energy security. The deficit reduction impact of the energy tax should reduce interest rates and thus capital costs, and that's beneficial for energy intensive industries which also tend to be capital intensive. Not only that, but other elements of our package, such as the investment tax credit and the AMT relief, should benefit those industries.

My next chart shows that even after our tax is fully in place, our energy costs will still be the lowest among our G-7 partners, or second lowest depending on what fuel you consider. And energy costs in Europe could go up even more if this new carbon or Btu tax they are talking about gets put into effect. The Japanese are also considering a new energy tax, although their energy costs already are among the highest in the world.

What will our proposal cost Americans? In general terms, it's well under 1 percent of disposable personal income. We calculate that, when fully phased in, the direct costs of the tax on electricity, natural gas, home heating oil, and gasoline for a typical family of four with an income of \$40,000 will be just \$9.50 per month. Our entire revenue program, including the energy tax, adds up to just \$17 a month for the average family at the \$40,000 level four years from now.

A family refinancing a \$100,000 mortgage down from 10 percent to 7 percent is already saving more than \$200 a month, or several times the energy tax. We have to remember that one of the goals of our deficit reduction program is to keep those interest rates down and reduce interest costs for consumers, business and government.

When we designed this tax, we paid very close attention to its impact on all Americans. A four-person family with earnings of \$25,000 is roughly \$40 a month better off when the expansion of the Earned Income Tax Credit is taken into account. And for families that do not qualify for the EITC, we've also expanded the Low-Income Home Energy Assistance Program (LIHEAP) and Food Stamps.

Now, let me get into a few of the more specific details, and then I'll try to answer your questions.

I. The Choice of the Energy Tax

Before we settled on a Btu tax, we considered a number of energy tax options in looking for the right combination of environmental and energy security benefits, regional neutrality, and balanced impact on market shares of our various energy sources.

We rejected taxes aimed at a specific fuel, such as gasoline or oil imports, because they would have a disproportionate impact on some regions of the country. The impact would be particularly severe in the case of an oil import fee, which would cause energy costs to increase by much more than the tax. If we'd taxed the carbon content of a fuel -- even though not specifically aimed at coal -- it would have a disproportionate impact on coal, and on the regions that produce and use coal.

We also considered an ad valorem tax on energy. We rejected this approach because it would amplify the effects of sudden changes in energy prices, and it would not provide a predictable stream of revenue.

The proposed Btu tax, unlike taxes aimed at a specific fuel, applies to the heat content of all major energy sources. Thus, no region gains or loses because of its dependence on a particular energy source, or because it is an energy-producing region or state. In addition, a Btu tax is a stable revenue source that is not directly tied to changes in energy prices.

This is not a pure Btu tax, with all sources taxed at the same rate. Instead, the tax is generally imposed at a basic rate of 25.7 cents per million Btus. But there is a supplemental rate of 34.2 cents per million Btus for oil. Without this extra tax on oil, the tax on natural gas would be higher, as a percentage of price, than the tax on petroleum products. Yet it will not hurt the sale of our domestic oil production, since every barrel will be sold, and the price will not be decreased. We also were concerned that not adding the supplemental rate would discourage natural gas use and frustrate the environmental and energy security objectives of the tax.

This is an important point here. We're quite serious about the goal of protecting the environment. Natural gas is a clean-burning fuel, and abundant supplies are available domestically. On the other hand, oil use, particularly as a motor fuel, contributes to air pollution. Additionally, as imports rise, so does the risk of environmental damage from oil spills, and the concern about energy security rises also.

Furthermore, additional imports increase our trade deficit. Last year we spent about \$43 billion on imported oil. That's more than half of our \$84 billion merchandise trade deficit. We get about 40 percent of our oil from overseas, and if we get too dependent on imported oil, we're more vulnerable to an embargo, as happened 20 years ago.

II Basic Design of the Energy Tax

I'm providing a detailed description of the Administration's proposed Btu tax with my testimony. I'd like to summarize the principal features.

As you know, when we announced our preliminary decision on the broad concepts of a Btu tax, we also invited comments from those most affected by the tax. In particular, we wanted to hear from the energy industry, industrial end-users, state and federal regulators, and congressional offices. As a direct result of these comments, including comments from many of you, we have significantly refined the initial proposal.

The tax is imposed on coal, refined petroleum products, natural gas, nuclear-generated electricity, and hydroelectricity. Imported fuels and electricity are taxed in the same manner as their domestic equivalents.

The basic tax rate of 25.7 cents per million Btus applies to all taxable energy sources. Refined petroleum products are subject to both the basic rate and the supplemental rate of 34.2 cents per million Btus. However, the supplemental rate does not

apply to liquefied petroleum gases, regardless of whether they're produced from natural gas or from crude oil. And it does not apply to natural gasoline and home heating oil.

We decided to collect the tax at a point that satisfies three criteria: it minimizes the number of taxpayers, or tax collectors; it is far enough downstream to ensure that fixed price contracts do not prevent a pass-through of the tax to the end user; and it is also far enough downstream to be certain that domestic and imported products are taxed at the same rate. Most of the collection points for the tax have been modified or clarified since our original proposal, generally as a result of applying these criteria to new information we got, some of it from committee members.

For example, Senators Boren, Breaux, and others expressed concern over the possibility that the tax on natural gas might be collected at the wellhead. We agree that could be a problem because it would involve large numbers of taxpayers. Many of them would be unable to pass through the tax because of fixed price contracts. We opted to generally impose the tax at the city gate. And, we decided the tax on oil should be collected at the refinery tailgate. That equalizes the tax applied to imported and domestic refined products.

In the coal industry, we found that if we put the collection point at the mine mouth, it would have caused three problems. Small mines would be burdened measuring BTU content. In some cases it would cause a doubling up on royalties and state severance taxes. And it could prevent a pass-through for fixed-price contracts. It makes more sense to put the collection point at the utility or industrial end-user. It should solve all three problems, and be far easier to administer.

A number of you told us there was a similar pass-through problem for independent power producers if they were operating with fixed-price contracts. We agreed, and we've addressed that concern with a special provision dealing with power produced under existing fixed-price contracts.

III. Application of the tax

We are not imposing the tax on nonfuel products, nonfuel uses of fossil fuels, or on exports. Nonfuel products include such things as asphalt, lubricants, and waxes. Nonfuel uses of fossil fuel include using it as a feedstock. The exemption for exports applies to both fuels and electricity. In the case of exported electricity generated from fossil fuel, an appropriate credit will be provided. Jet fuel and bunker fuel used in international transportation will be exempt so there's no competitive problem in this industry.

The last time I was here, a number of you raised some issues about the application of the tax, and we've addressed many of those with clarifications. For example, Senator Conrad alerted us to the potential for a double tax on the coal gasification facility, which makes synthetic natural gas from lignite coal. In effect, we would have been taxing the coal that went into the synthetic natural gas production, and then turning right around and taxing the synthetic natural gas. We didn't intend for that to happen. We're just going to tax the synthetic natural gas.

You've got something similar in pumped storage for generating electricity. You know how that works. In off-peak times you use some power, pump the water back uphill, then run it down through turbines at peak times to get extra electricity. Under our original proposal, both the power used to pump the water, and the hydroelectricity, would have been taxed. Now we're going to tax that power only once.

Senator Wallop will tell you it takes steam to get heavy oil out of the ground. To meet environmental regulations, you often have to buy natural gas from off the site to produce the steam. We'd have been taxing that gas, but not taxing heavy oil from the site used for the same purpose. That wouldn't be fair, and we didn't want to hurt heavy oil production. We fixed that problem. The natural gas is exempted.

We also learned that the energy industry had a similar problem in cases where they use energy to extract or process fuels. We have exempted crude oil or natural gas that is used where it is extracted, to get out more crude oil or natural gas. And, we will not tax crude oil used in a refinery, or natural gas used in a natural gas processing or fractionation plant.

Senators Daschle, Conrad and others had concerns about the application of the tax to ethanol and methanol. When we looked into it, we concluded that oxygenates such as ethanol, methanol, ETBE, and MTBE -- and the feedstocks used to produce them -- should not be taxed. This decision is consistent with our objectives of encouraging use of alternative fuels, reducing our dependence on foreign oil and cutting down on pollution.

One of the things we were very concerned about was making certain our proposal had regional balance. Initially we looked at applying the supplemental oil rate to home heating oil. Chairman Moynihan and Senator Mitchell reminded us that in many areas natural gas is not available for home heating. Homes in those areas are dependent on home heating oil, propane or butane. By treating home heating oil as we treat other home heating fuels, like natural gas and propane, we maintain the balance across our regions.

There also were concerns in the Northwest about the partial application of the oil supplemental rate in the formula for taxing hydroelectricity. We responded to those concerns, but we believe hydroelectricity should be subject to the tax itself. Although hydroelectricity is arguably a renewable source, the energy tax is a deficit reduction measure. Exempting hydroelectric power entirely would cost substantial revenue, and taxing it is necessary for regional balance. We cannot ask other regions to pay a tax on home energy costs but exempt regions where those costs are now the lowest.

Lastly, environmental concerns led us to exempt coal seam methane from a mine being degassed prior to operation. We did that because it encourages capturing that greenhouse gas rather than venting it into the atmosphere.

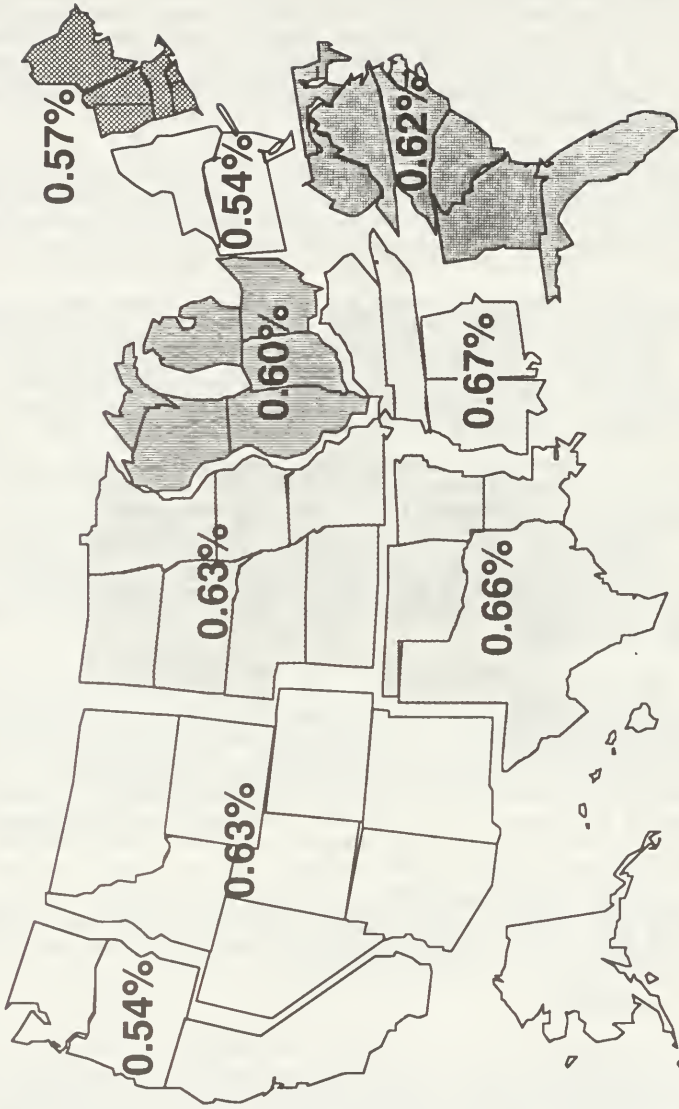
IV. Conclusion

As you see on my last chart, the energy tax offers us a significant opportunity to make a major contribution to our deficit reduction plan, while simultaneously cutting pollution, encouraging energy conservation and reducing our dependence on imported fuel. And, as we lower that deficit, we get lower interest rates, more investment, and more productivity. When we do all of that, we improve wages and our long-term standard of living.

Mr. Chairman, raising taxes is never an easy or popular process. I know the votes that lie ahead for the committee may be difficult ones. But I have sensed a new realism in Congress and among the American people. I think everyone now knows that we must change the status quo if we are to change our nation's economic course.

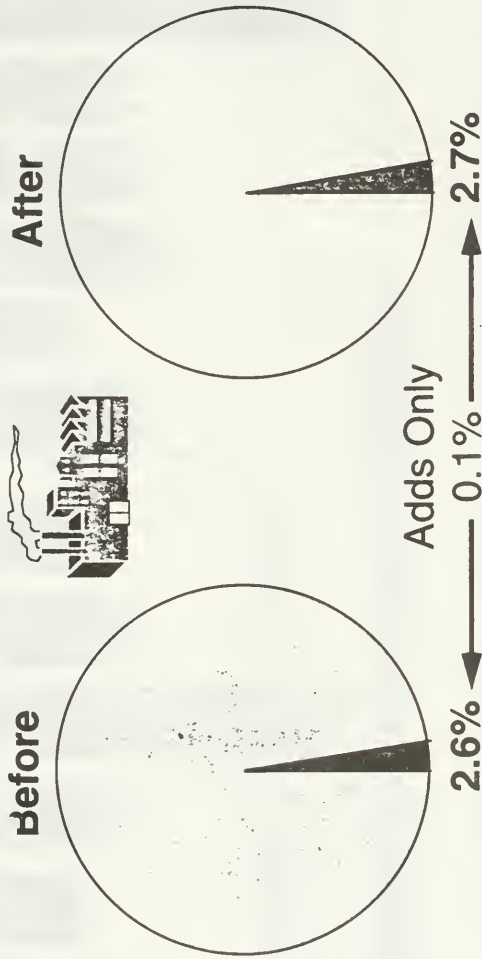
This tax offers a way to do that, and I look forward to working with all of you on this and our other programs.

ENERGY TAX AVERAGES LESS THAN 1% OF CONSUMERS' INCOME* ACROSS THE COUNTRY



*Disposable Personal Income
Source: Derived from Department of Energy data.

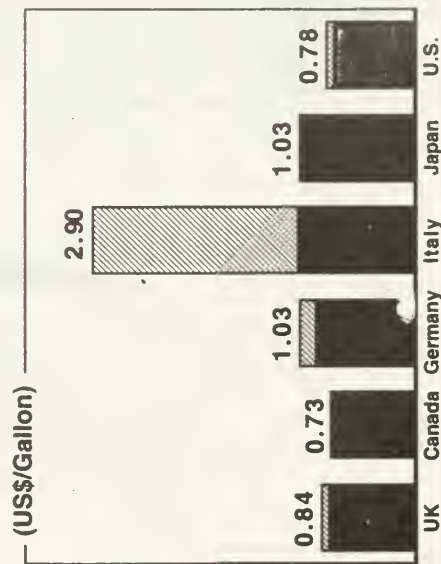
ENERGY TAX HAS SMALL EFFECT ON MANUFACTURERS



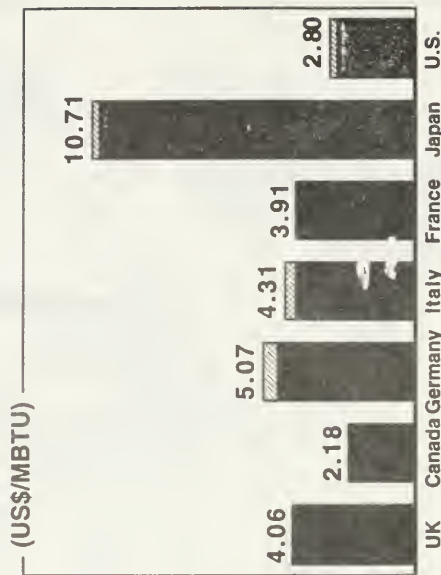
Manufacturers Production Costs

Source: Department of Commerce

U.S. STILL HAS LOWER ENERGY PRICES THAN MOST G-7 COMPETITORS



Distillate Oil



Natural Gas

Taxes
 Prices

ENERGY TAX CONTRIBUTES TO NATIONAL GOALS

☒ Reduces Pollution

☒ Promotes Conservation

☒ Lessens Dependence on Foreign Oil

☒ Deficit Reduction

RESPONSES OF SECRETARY BENTSEN TO QUESTIONS SUBMITTED BY SENATOR ROTH

1. **Question:** Will Treasury prepare a distribution of the Administration's revenue proposals using adjusted gross income (AGI), rather than Family Economic Income, as the income classifier? If not, then why not?

Answer: Distribution tables show the effect by income class of all taxes, including excises, payroll taxes, and the corporate income tax, as well as the individual income tax. Professional economists are in agreement that the fairness of the tax system can only be assessed if the income measure used in the tables provides a reasonable ranking of families by their economic well-being. Family Economic Income, the income classifier used by the Treasury Department to prepare distribution tables, and similar broad-based income measures provide reasonable rankings; AGI would not.

AGI is a concept specific to the individual income tax and was never intended to be a proper measure of income for distribution tables. AGI omits a number of income items that clearly are part of a family's economic well-being. For example, AGI excludes tax-exempt interest, most government transfer payments, IRA and other deductible retirement savings contributions, and employer-provided fringe benefits such as health insurance. Also excluded are most pre-tax corporate profits, which are the base for the corporate income tax. AGI may include more income than a family actually earns in a year. For example, capital gains are generally included in AGI in the year the gains are realized even though the gains may have accrued over many years, and gains are not adjusted for inflation.

Family Economic Income is a broad measure of income that includes items of income omitted from AGI, and adjusts the measure of certain items included in AGI (for example, capital gains are measured on an inflation-adjusted, annual accrual basis). Unlike AGI, which may be redefined by changes in the income tax, Family Economic Income is independent of the tax law itself, so families are classified in the proper income class even when the tax law changes. (Significant changes to the definition of AGI, for example, were made in the Tax Reform Act of 1986.) Further, Family Economic Income includes all income of all family members for all families; AGI is reported on tax returns, which are not filed by a significant number of families with AGIs below the tax filing thresholds, while some families have two or more filing units (each of which reports only its part of the family's AGI).

For lower- and middle-income families, over 90 percent of Family Economic Income on average is included in AGI or is in other forms of cash income, and over 95 percent is in cash or fringe benefits. Only for high-income families, those with Family Economic Incomes of \$100,000 or more, do non-cash forms of income represent a meaningful share of the total.

Professional tax economists at universities, in research centers, and in State governments all use broad income measures in distribution tables. The Congressional Joint Committee on Taxation (JCT) and the Congressional Budget Office (CBO) also use measures of income considerably broader than AGI in their distribution tables. The Treasury Department has used Family Economic Income continuously in its distribution tables since 1984, and used a very similar concept in distribution tables during the Ford Administration.

The Treasury Department continues to believe that a distribution table using AGI as the income measure would confuse, rather than clarify, assessment of the Administration's revenue proposals.

2. **Question:** What is the eligibility for the Earned Income Tax Credit (EITC) by AGI class for returns by filing status and, within each filing status, for filers with and without children? What is the impact of the energy tax and the proposed increases in the EITC, Low Income Home Energy Assistance Program (LIHEAP), and foodstamps by income class?

Answer: The enclosed table (Enclosure 1) shows, by AGI class up to \$30,000 and over (above \$30,000 of AGI no returns are eligible for the EITC) for joint returns filed by couples

with children, head of household returns with children, joint returns without children, and other returns (single, married filing separate, and head of household without children) the percentage of returns in each category that are eligible for the EITC.

The second enclosed table (Enclosure 2) shows, by income class and for each year from 1994 through 1997, the average monthly impact of the Administration's entire revenue proposal, including the energy tax and the proposed increases in the EITC, LIHEAP, and foodstamps. The table shows that on average over the 1994-1997 period, families with incomes of less than \$30,000 will receive a tax cut of \$2 per month, and families in the \$30,000 to \$50,000 income class will have a tax increase of \$10 per month.

3. **Question:** Will indexing the energy tax rate for inflation result in automatic tax increases for low- and middle-income taxpayers and increase the incentive for government to pursue inflationary policies? Is an automatic increase in tax rate built into any other tax?

Answer: Indexing of the energy tax rate may result in nominal tax increases for families at all income levels. The energy tax burden relative to income for each family, however, should remain the same as incomes rise (and actually decrease to the extent the tax encourages energy efficiency and the use of lower-taxed fuels).

Indexing the tax does not increase the incentive for government to pursue inflationary policies. Inflationary policies would increase government expenditures as much as government revenues, thus resulting in no net revenue to the government. Prior to 1985, unindexed exemptions and rate brackets caused government revenues to increase faster than the rate of inflation, whereas with indexation the energy tax rate will rise only at the same rate as inflation.

The only other tax that includes an automatic increase in rate is the tax on ozone-depleting chemicals, which provides for increases of 45 cents per year after the phase-in period. All taxes, however, are equal to the tax rate multiplied by the tax base. For many taxes the tax base is effectively indexed for inflation. These taxes include ad valorem excises (e.g., the luxury excise tax, the telephone excise tax, and the air transportation excise tax), the income tax, estate and gift taxes, and payroll taxes.

4. **Question:** How did Treasury calculate the regional impacts of the energy tax? How does this relate to the Treasury's figures for the impact of the entire package of revenue proposals?

Answer: The enclosed table (Enclosure 3) provides information on the regional impacts of the Administration's proposed energy tax when the rates are fully phased in (July 1, 1996). The first column of the table shows by Census region the dollar amount of tax that would be paid on a per capita basis. The second column of the table expresses the tax as a percent of disposable personal income in each region. The third and fourth columns show the same information as the first two columns, but expressed as a percent of the national average. A map showing Census regions and data from the second column follows the table.

The table is based on Department of Energy data on energy consumption (in Btus) by energy source, sector (residential, commercial, industrial, and transportation), and area, and Department of Commerce data on population and disposable personal income by area. The applicable energy tax rates were first applied to each energy source for each sector. The total tax for each sector was then allocated by Census region in the following manner, which is meant to reflect the underlying assumption that the entire energy tax will be fully passed forward to households. Taxes on 100 percent of residential energy consumption, 50 percent of commercial energy consumption, and 80 percent of motor gasoline transportation consumption were allocated to the Census region where the energy was consumed. Taxes on the remaining 50 percent of commercial energy consumption and 20 percent of motor gasoline consumption, as well as 100 percent of taxes on industrial energy consumption and on non-motor gasoline transportation consumption were assumed to be borne by households in proportion to their total consumption of all products, and allocated by Census region on the basis of each region's share of aggregate disposable personal income.

The total amount of energy tax allocated to a region was then divided by the total population in the region to obtain the first column of the attached table. The second column of the table was obtained by dividing the total amount of energy tax allocated to a region by the amount of disposable personal income in the region.

There are no discrepancies in the figures Treasury has released on the regional impact of the energy tax and on the impact of the Administration's total revenue proposal (see the answer to question 2, above). Both sets of figures include the total (direct and indirect) effect of the energy tax. The regional figures, however, do not take into account the offsets to the energy tax (such as the expansion of the EITC), whereas these offsets are taken into account in the income distribution table (Enclosure 2).

5. **Question:** Why are Treasury's revenue estimates for the energy tax lower than private estimates? Would Treasury oppose a further increase in the energy tax?

Answer: The revenue estimates prepared by Treasury (and the Joint Committee) for the energy tax are net of the "income offset," which is the reduction in income and employment taxes because GDP and the price level are assumed to be unchanged in making the estimates (the assumption is standard for making all Budget estimates, including all revenue estimates). Note that in Treasury figures showing the effect of the energy tax on product prices and consumers (e.g., in the regional impacts shown in Enclosure 3), the figures are not reduced by the "income offset."

The Administration has not proposed any future increases in the energy tax, and has no plans at this time to propose such an increase.

6. **Question:** Does any other major industrialized nation impose a specific broad-based energy tax? If so, what are they, and do they offer offsetting manufacturing subsidies?

Answer: Currently, the Scandinavian countries and Belgium have broad-based energy taxes. These taxes provide some reductions for manufacturers and other users. For example, manufacturers and farmers are taxed at 25 percent of the base rate of the Swedish carbon tax (which is substantially higher than the proposed U.S. energy tax). No energy tax is imposed at the border on non-energy imports, and no rebate is made for exports, under these taxes.

The proposed EC carbon/Btu tax, which would phase in over ten years, would be much higher than the proposed U.S. tax. It would provide reductions in tax for energy-intensive industries (defined as industries with high ratios of energy costs to value-added); these reductions could be as high as 90 percent. The proposed U.S. energy tax, however, when fully phased in, would tax fossil fuels at rates that are 70 to 85 percent lower than the proposed EC tax when fully phased in. Therefore, even with the largest possible reductions, the proposed EC tax would be about as large as the proposed U.S. tax. The EC tax would not provide border tax adjustments for imports or exports.

Question: Is this tax "import neutral" so that U.S. manufacturers are not placed at a disadvantage in the international marketplace? Won't this proposed energy tax place an additional burden on U.S. manufacturers that will not be borne by their foreign competitors? Is there any way to quantify the impact these increased costs would have on our international competitiveness?

Answer: The Administration's proposed Btu tax would raise manufacturing production costs by an average of just 0.1 percent. This is unlikely to hurt the competitive position of most U.S. exporters. Even for the most energy-intensive industries, the Btu tax will increase production costs by no more than 4 percent. Offsetting this increase, other elements of the Administration's economic proposals, especially deficit reduction, have already reduced interest rates and thus will reduce capital costs for exporting industries.

The Ways and Means Committee bill would reduce the effect of the tax on domestic producers. The bill includes exemptions from the supplement rate for diesel and gasoline used on farms and

a feedstock exemption for electricity used in electrolytic processes. In addition, the Ways and Means Committee bill provides a border adjustment on imports of energy-intensive products.

Question: What would be the average increase in the price of an American automobile as a result of the energy tax?

Answer: By 1998, when the energy tax is fully implemented, the average price of a new car will increase \$64 as a result of direct and indirect effects of the energy tax. This rise in the average price of a new car reflects the direct and indirect effects of increases in the price of input materials — fabricated metal, rubber, glass, machinery, other transportation equipment and a host of other industrial commodities which go into the production of a car.

7. **Question:** Will the energy tax disproportionately affect lower-income elderly?

Answer: Lower-income elderly, who receive a substantial amount of their income from Social Security benefits, will at most be modestly affected by the energy tax. Even middle-income elderly will be substantially protected from the energy tax.

The energy tax will not reduce the purchasing power of Social Security benefits, because the automatic COLA (inflation indexing) will offset any effect of the energy tax on the real value of Social Security benefits. (Note that if prices do not rise due to the energy tax, Social Security benefits will likewise purchase the same real amount of goods and services.) Some elderly also receive fully or partially indexed pensions, and will be protected at least to some extent by adjustments to this income source as well. As a result, low- and middle-income elderly will not experience any reduction in their real incomes due to the energy tax to the extent their income consists of Social Security benefits and indexed pension benefits.

In addition, the low-income elderly will qualify for the Administration's proposed expansions of LIHEAP and of food stamps. Moreover, low-income elderly workers without children, and low- and moderate-income elderly workers with qualifying children, will also qualify for the Administration's proposed expansions to the EITC.

8. **Question:** Why has the Administration proposed that the energy tax be levied at the city gate, collected by the local distribution company and remitted to the Treasury by the pipelines? Would collection from the end user be more administratively efficient and better promote energy conservation?

Answer: In the Ways and Means Committee bill, the ultimate user of natural gas generally is liable for the tax. In the case of natural gas removed from an LDC by an ultimate user, the LDC collects the tax and is generally secondarily liable for the tax to the extent that the user does not pay the tax to the LDC. For natural gas removed directly from a non-LDC pipeline by an ultimate user, the pipeline operator collects the tax (but is not secondarily liable for the tax).

9. **Question:** Is your proposal to have the interstate natural gas pipeline remit to the Treasury the tax they collect from local distribution companies or end-users workable given the Federal Energy Regulatory Commission (FERC) ordered restructuring of the interstate natural gas pipeline industry under their order 636? Since gas transmission is now a complex set of transactions between numerous parties with the number of transactions for a single delivery of gas easily reaching a dozen, is it realistic to think that the pipeline is in the best position to remit the tax to the Treasury?

Answer: The Ways and Means Committee bill provides that for natural gas removed directly from a non-LDC pipeline by an ultimate user, the pipeline operator collects the tax from the end user (but is not secondarily liable for the tax). For natural gas removed from an LDC by an ultimate user, the LDC collects the tax from the user and is generally secondarily liable for the tax. The Committee bill provides for both tax-free transfers to certain registered recipients and for downstream refunds.

10. Question: What provisions of the Administration plan will prevent young single taxpayers with \$11,000 of adjusted gross income (AGI) and young childless married couples with \$16,000 of AGI from experiencing tax increases? What is the lowest level of AGI at which a tax increase, net of proposed offsets, could occur?

Answer: The Administration recognizes that deficit reduction entails tax increases for many taxpayers. The Administration's program includes a number of specific proposals that offset the effect of tax increases for low-income households (i.e., increased funding for LIHEAP and food stamps and expansion of the EITC). Although families with children will receive much of the relief provided under these proposals, low-income single and childless taxpayers may also benefit.

Young taxpayers will benefit disproportionately from deficit reduction. Today's deficit reduction efforts will lower tax burdens for young taxpayers in their peak earning years. Moreover, young taxpayers are generally net borrowers and will benefit immediately from lower interest rates. Although not part of the budget plan, the educational assistance proposed in the Administration's national service plan will also disproportionately benefit young taxpayers.

The lowest level of AGI at which a tax increase, net of proposed offsets, could occur is zero. For example, an individual with tax-exempt interest income of \$200,000 and no other income has no AGI. That individual would not qualify for the EITC, LIHEAP, or food stamps, and would bear the full burden of the energy tax.

11. Question: What is the additional monthly burden of the energy tax on families?

Answer: Enclosure 2 shows, by income class and for each year from 1994 through 1997, the average monthly impact of the Administration's entire revenue proposal, including the total (direct and indirect) effects of the energy tax. The table shows that for families in the \$30,000 to \$50,000 income class, with average incomes of about \$40,000, the effect of the Administration's entire revenue proposal will be a tax increase of \$17 per month in 1997 when the energy and other taxes are fully phased in.

12. Question: Does Treasury agree with Senator Conrad's estimates that the energy tax, when fully phased in, for an average family farm in North Dakota will be \$1,200 per year? How were the estimates cited by Treasury, that the energy tax would add 0.4 percent to agricultural production costs and 0.1 percent to overall manufacturing costs, derived? Has Treasury attempted to estimate the impact of the energy tax on the international competitiveness of agriculture and manufacturing?

Answer: Senator Conrad's estimate is for a typical North Dakota grain farm of 1,264 acres, with 610 acres in wheat, 180 in barley, 60 in oats, 160 in sunflowers or oilseeds, and 254 acres fallow. Based on USDA estimates of the cost of the energy tax per acre in North Dakota for various crops, the Treasury estimates that the total annual effect of the fully phased in energy tax, as proposed by the Administration and modified by the Ways and Means Committee, on the typical North Dakota grain farm, including the household, used in Senator Conrad's example would be \$382. Note that these estimates do not take into account increased energy conservation by the farmer in response to the tax. Further, comparison of the cost estimates to net farm income implicitly assumes that all farm product prices will remain constant rather than reflecting the increased farm costs due to the energy tax. In addition, the estimates do not take into account the effect of offsets to the energy tax, such as the increase in the EITC. Using an average family farm income of \$17,600, the increase in the EITC for a family with two or more children under the Administration's proposal will be \$961.

The estimate for the impact of the energy tax on overall manufacturing costs was made by the Department of Energy using data from the Department of Commerce on direct energy purchases and total production costs for manufacturers. Applying estimates of the cost increases for energy purchases due to the fully phased-in energy tax to the energy purchase data resulted in an estimate that direct energy purchases as a share of total production costs would increase from 2.6 percent to 2.7 percent, an increase of 0.1 percent. Note that increased energy conservation by manufacturers in response to the tax is not taken into account in these estimates.

The estimate for the impact of the energy tax on agricultural costs is based on USDA data on farm production costs by type, including direct energy expenditures. Applying estimates of the cost increase due to the fully phased-in energy tax to the energy expenditure data resulted in an estimate that direct energy expenditures as a share of total farm production costs would increase from 5.8 percent to 6.2 percent, an increase of 0.4 percent. Note that increased energy conservation by farmers in response to the tax is not taken into account in these estimates.

The Treasury Department has not made direct estimates of the effect of the energy tax on the international competitiveness of the manufacturing and agricultural sectors. However, we do not believe the overall impacts will be large, given the relatively small impacts of the tax on production costs. Further, the energy tax and other elements of the Administration's deficit reduction proposals have already reduced interest rates, making our exporting sectors more competitive by reducing their capital costs. In addition, it should be noted that even with the energy tax fully in place, energy prices in the United States will remain the lowest or second lowest (depending on the type of energy) in the G-7 countries. Moreover, as stated in the response to question 6, the Ways and Means Committee bill provides a border adjustment on imports of energy-intensive products.

13. Question: What is Treasury's estimate of the impact of the energy tax on GDP?

Answer: The Treasury Department has not made any estimates of the impact of the energy tax on GDP or other macroeconomic variables. The energy tax is only one component of the Administration's total Budget proposal. We believe that the impact of the overall Budget proposal on the economy should be quite favorable. The prospect of lower future deficits due to the proposals have already led to lower interest rates, reducing the cost of capital for business, and mortgage interest and other borrowing costs for families. Investment initiatives in the Budget should also encourage economic growth and productivity.

Enclosure 1

Percentage of Returns Eligible for the EITC Under the Administration's Proposal (1)

| Adjusted Gross Income (000) | Joint Returns with Children (Percent) | Head of Household Returns with Children (Percent) | Joint Returns without Children (Percent) | Other Returns (2) without Children (Percent) |
|--------------------------------------|---|--|--|--|
| 0 - 10 | 93.3 | 98.8 | 60.7 | 47.1 |
| 10 - 20 | 94.0 | 98.4 | 0.0 | 0.0 |
| 20 - 30 | 55.7 | 57.9 | 0.0 | 0.0 |
| 30 and over | 0.0 | 0.0 | 0.0 | 0.0 |

Department of the Treasury
Office of Tax Analysis

May 14, 1993

- (1) Assumes the fully phased in (1995) Administration proposal. Returns are those filed under current law or that will be filed under the proposal.
- (2) "Other Returns" includes single returns, returns of couples filing separately, and head of household returns without children.

Enclosure 2

**Administration's Revenue Package, Taking Account of
Phase In of Energy Tax and Gasoline Tax Extension (1)
(1994 Income Levels)**

| Family Economic Income Class (2) (\$000) | Number of Families (Millions) | Average Tax Per Family Per Month | | | | |
|--|-------------------------------------|----------------------------------|-------|-------|-------|------------------------|
| | | 1994 | 1995 | 1996 | 1997 | - Average 1994-1997 |
| 0 - 10 | 14.0 | -4 | -3 | -1 | -1 | -2 |
| 10 - 20 | 18.4 | -4 | -3 | -1 | 0 | -2 |
| 20 - 30 | 18.0 | -7 | -4 | 0 | 2 | -2 |
| 30 - 50 | 22.4 | 1 | 7 | 14 | 17 | 10 |
| 50 - 75 | 17.4 | 14 | 22 | 32 | 38 | 26 |
| 75 - 100 | 9.9 | 20 | 31 | 44 | 49 | 36 |
| 100 - 200 | 8.8 | 41 | 54 | 69 | 76 | 60 |
| 200 & over | 2.4 | 1,139 | 1,182 | 1,188 | 1,198 | 1,172 |
| Total (3) | 110.7 | 30 | 36 | 43 | 46 | 38 |

Department of the Treasury
Office of Tax Analysis

February 19, 1993

- (1) This table distributes the estimated change in average monthly tax liabilities per family due to the Administration's revenue proposals, including taxation of Social Security Benefits. Included by 1997 is a total of \$10.2 billion of expansions in the EITC and increases in transfers for Food Stamps and the Low-Income Home Energy Assistance Program (the EITC expansions are effective beginning in 1994, while other increases are phased in with the energy tax). The energy tax is imposed at one-third rates 7/94, at two-thirds rates 7/95, and at full rates beginning 7/96. The gasoline tax extension is effective 10/95.
- (2) Family Economic Income (FEI) is a broad-based income concept. FEI is constructed by adding to AGI unreported and underreported income; IRA and Keogh deductions; nontaxable transfer payments such as Social Security and AFDC; employer-provided fringe benefits; inside build-up on pensions, IRAs, Keoghs, and life insurance; tax-exempt interest; and imputed rent on owner-occupied housing. Capital gains are computed on an accrual basis, adjusted for inflation to the extent reliable data allow. Inflationary losses of lenders are subtracted and gains of borrowers are added. There is also an adjustment for accelerated depreciation of noncorporate businesses. FEI is shown on a family rather than a tax-return basis. The economic incomes of all members of a family unit are added to arrive at the family's economic income used in the distributions.
- (3) Families with negative incomes are included in the total line but not shown separately.

Impact on Consumers of Energy Tax by Region

| Census Region | Tax Increase | | Percent of National Average | |
|--------------------|----------------------|---------------------------|-----------------------------|---------------------------|
| | Amount Per Capita | As A Percent of Income | Amount Per Capita | As A Percent of Income |
| New England | \$ 124 | 0.57% | 112% | 95% |
| Middle Atlantic | 115 | 0.54 | 104 | 91 |
| South Atlantic | 113 | 0.62 | 102 | 104 |
| East North Central | 110 | 0.60 | 100 | 101 |
| East South Central | 102 | 0.67 | 92 | 113 |
| West North Central | 110 | 0.63 | 100 | 106 |
| West South Central | 106 | 0.66 | 96 | 111 |
| Mountain | 104 | 0.63 | 95 | 106 |
| Pacific | 108 | 0.54 | 98 | 91 |

4/1/93

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C.

June 15, 1993

SECRETARY OF THE TREASURY

The Honorable John D. Rockefeller IV
 United States Senate
 Washington, D.C. 20510

Dear Jay:

I appreciated the opportunity to describe in detail the Administration's proposed modified Btu tax in my recent testimony before the Senate Finance Committee. I am happy to respond to your follow-up letter of April 23, which asked for my comments on correspondence you received from Mr. George B. Kitchens, President of West Virginia Power.

Mr. Kitchens asked whether the Treasury Department had thought about the problems of taxing farm-tap gas (i.e., natural gas that is provided to a farmer from a tap into a pipeline that crosses the farmer's land). A limited amount of farm-tap gas is provided free of charge in exchange for the pipeline right of way, and the remainder is sold to the farmer either directly by the pipeline or by the local distribution company (LDC) that meters the gas delivered to the farmer.

The Administration's proposed tax, as modified by the Ways and Means Committee, is imposed on the person receiving the natural gas when it is removed from the pipeline (including an LDC pipeline) unless it is removed into another registered pipeline. The tax is collected by the pipeline from which the gas is removed and, in the case of gas removed from an LDC pipeline, the LDC is generally secondarily liable for the tax. It is our understanding that these rules were developed by the Ways and Means Committee in response to concerns expressed to the Committee by the American Gas Association and a number of its member LDCs.

Under these rules, the tax on gas that a farmer receives free of charge or purchases directly from the pipeline would be imposed on the farmer and would be collected by the pipeline. The LDC would not be secondarily liable for this tax because the gas is not removed from the LDC's pipeline system. If, however, the LDC receives the gas for resale to the farmer, the ways and means proposal is unclear regarding who would be liable for the tax--the farmer or the LDC, and who would be responsible for collection--the pipeline or the LDC.

Mr. Kitchens noted that in some cases farm-tap gas may not be metered. Neither the Administration's bill nor the Ways and Means' proposal requires the installation of meters where none currently exist. We assume, however, that pipelines and LDCs will use reasonable estimating procedures in determining the amount of gas delivered to unmetered customers.

Mr. Kitchens also asked how many farm taps there are in the United States, and how many are not metered. We forwarded this question to the Energy Information Administration (EIA), which collects energy data for the government. EIA has informed us that it cannot quantify either the number of farm taps or the extent to which they may be unmetered.

I am sending a copy of this letter to Chairman Moynihan, so that he has a complete record of the testimony and follow-up questions.

Sincerely,


 Lloyd Bentsen

RESPONSE OF SECRETARY BENTSEN TO A QUESTION SUBMITTED BY SENATOR RIEGLE

IMPACT OF ENERGY TAX ON MICHIGAN

Question: What is the Treasury Department's analysis of the assertions made in the mailer prepared by the Consumers Power Company of Michigan? (Senator Riegle)

Answer: The mailer asserts that the Administration's proposed energy tax would: (1) raise energy bills approximately \$150 per year and the cost of goods and services by \$250 per year, for a total cost of \$400 per year; (2) reduce the global competitiveness of Michigan businesses; (3) increase inflation and interest rates; and (4) particularly hurt states like Michigan that have more severe weather and energy-intensive manufacturers. The Treasury's analysis of each of these assertions is as follows.

1. Cost Michigan Families \$400 Per Year. The Treasury Department has not made estimates of the impact of the energy tax on typical families in each state. However, it has estimated the impact, on families at each income level, of the Administration's entire revenue proposals, including the direct and indirect effects of the proposed energy tax. Those estimates indicate that for a typical family with an income of about \$40,000 the total cost of the Administration's proposals, when the energy tax is fully phased in, will be \$198 per year (a little less than \$17 per month). (This figure is essentially unchanged by the Ways and Means Committee amendments to the Administration's proposal.) The Treasury Department has also prepared estimates of the total (direct and indirect) impact of the energy tax, when fully phased in, by geographic region. Those estimates indicate that the impact on a per capita basis in the East North Central Region, which includes Michigan, will be identical to the national average. This suggests that the impact of the Administration's entire revenue proposals, including the energy tax, on a typical family in Michigan with \$40,000 of income may be closer to the national average of \$198 per year than to the \$400 figure given in the mailer.

2. Reduce the Global Competitiveness of Michigan Businesses. The proposed energy tax will raise manufacturing production costs by an average of just 0.1 percent. This is unlikely to hurt the competitive position of most U.S. businesses. Further, the energy tax and other elements of the Administration's deficit reduction proposals have already reduced interest rates, making U.S. businesses more competitive by reducing their cost of capital. The Administration's investment initiatives should also improve the competitive position of U.S. businesses. In addition, it should be noted that even with the proposed energy tax fully in place, energy prices in the United States will remain the lowest or second lowest (depending on the type of energy) in the G-7 countries. Finally, the House bill imposes a border tax on imports of energy-intensive products. Thus, domestically manufactured products will not be disadvantaged relative to imports.

3. Increase Inflation and Interest Rates. As noted in the response to assertion 2, the proposed energy tax, by lowering expectations of future deficits, has helped reduce interest rates. There is every reason to expect that interest rates will continue to be lower than they would have been without the deficit reduction effect of the energy tax. As to inflation, the proposed energy tax may lead to very modest, one-time increases in the price level as it is phased in over three years. Inflation is defined by economists as a sustained increase in the price level. There is no reason to expect the possible one-time increases in the price level as the energy tax phases in to lead to sustained price level increases. So, while prices might increase by the amount of the energy tax, the tax would not meet economists' definition of being inflationary.

4. Particularly Hurt Michigan. The proposed modified Btu energy tax was chosen over other forms of energy taxes in part because of its regional balance. As noted in the response to assertion 1, Treasury's estimates of the geographic impact of the proposed energy tax indicate that the impact on the region that includes Michigan is right at the national average. Our analysis, therefore, is that the tax will not particularly impact Michigan, or any other State.

RESPONSES OF SECRETARY BENTSEN TO QUESTIONS SUBMITTED BY SENATOR BREAUX

DOMESTIC OIL

Question: Won't the energy tax cause a decline in domestic oil production before it reduces imports because domestic oil is more expensive to produce and production costs for domestic oil will be increased by the tax? (Senator BreauX)

Answer: Domestic production at current levels will not become uneconomical because of the tax.

The effect of the tax on production costs is minimized by a number of exemptions.

- Crude oil or natural gas used, on the premises where it is produced, to produce crude oil or natural gas is exempt.
- Natural gas and coal used in enhanced oil recovery for heavy oil is exempt.
- Oil and refined petroleum products used in a refinery are exempt.

Domestic production at current cost levels will not become uneconomical because of the tax.

- The Department of Energy projects that the tax will reduce crude oil prices in the year 2000 by less than one percent.
- Even with this reduction, the Department of Energy projects that crude oil prices in the year 2000 will be nearly 15 percent above their 1990 levels.

Oil imports, rather than domestic production, will decrease because the tax will reduce U.S. consumption of oil, without any significant effect on U.S. production of oil.

- Reduced U.S. consumption will lead to a drop in world oil production.
- The drop in world oil production will be either spread uniformly across all producing countries (if OPEC tries to maintain market share) or concentrated in OPEC countries (if OPEC tries to maintain price levels).

Under the House bill, imported refined petroleum products will be subject to a border adjustment tax for embedded energy costs. Thus, domestic refined products will not be disadvantaged relative to imports.

CHEMICAL INDUSTRY

Question: Will the energy tax, like the original version of the Superfund tax, seriously reduce the ability of the domestic chemical industry to compete with foreign manufacturers? (Senator Breaux)

Answer: Although the chemical industry is energy intensive, the tax will increase domestic production costs by less than one percent.

The effect of the energy tax on petrochemical production is minimized by the exemption for feedstocks.

In many cases, the effect of the energy tax will be substantially less than the Superfund tax, which in some cases approached \$5.00 per ton.

As a capital-intensive industry, chemicals will derive greater than average benefits from the lower interest costs which have already resulted from the President's deficit reduction package and from the Administration's proposed alternative minimum tax relief.

Under the House bill, a border tax is imposed on imports of energy-intensive products. Thus, domestically manufactured primary products will not be disadvantaged relative to imports.

**RESPONSE OF SECRETARY BENTSEN TO A QUESTION SUBMITTED BY
SENATOR PACKWOOD**

ENERGY TAX ON FAMILIES WITH INCOMES UNDER \$75,000

Question: Does the Treasury agree with the CBO figure that 70 percent of the energy tax falls on people who make \$75,000 or less? (Senator Packwood)

Answer: The energy tax is one component of the Administration's revenue proposals, and it is the distributional effect of the entire package of proposals, rather than a particular component, that we believe is relevant to consideration of the package.

The Treasury's distributional analysis of the Administration's fully phased in revenue proposals (including the offsets to the energy tax -- increases in the Earned Income Tax Credit, and increased funding for the Low-Income Home Energy Assistance Program and Food Stamps) show that only 20 percent of the revenue changes will be paid by families with incomes of \$75,000 or less. A CBO distributional analysis of the Administration's revenue proposals shows that less than 18 percent of the revenue changes will be paid by families with incomes of \$75,000 or less.

CBO has produced a distributional analysis of the energy tax net of offsets, as proposed by the Administration, that shows that a little over half (54 percent) would be paid by families making \$75,000 or less. As indicated above, however, we believe that the relevant distributional analysis is for the package as a whole.

To illustrate the impact of the energy tax, Treasury has provided examples for four-person families at various income levels below \$75,000. For example, when fully phased in, the impact of the energy tax, as proposed by the Administration, on the direct energy expenditures of a four-person family with income of \$40,000 will be \$9.50 per month. The comparable figure under the House bill is \$9.49.

RESPONSES OF SECRETARY BENTSEN TO QUESTIONS SUBMITTED BY
SENATOR DANFORTH

ADDITIONAL TAXES FOR HEALTH CARE

Question: Will the Administration's health care plan require additional taxes on top of the \$295 billion revenue increase in the Administration's economic plan? (Senator Danforth)

Answer: The Administration's health care plan is still being formulated, and thus it would be inappropriate to comment at this time on specific revenue requirements. The health care plan has two basic objectives: keeping down the cost of health care, which has been growing at an unsustainable rate, and providing access to health care to all Americans.

VALUE-ADDED TAX AND ENERGY TAX

Question: Given that a value-added tax (VAT) has been considered as a mechanism for funding health care reform, does a separate energy tax make sense, and should they be considered piecemeal? (Senator Danforth)

Answer: Although a variety of different taxes, including a VAT, were reviewed by members of the Administration's health reform task force as potential methods of financing health care reform, a VAT is not now actively under consideration. The imposition of a Btu energy tax is designed to meet objectives different from a VAT (aside from generating revenues needed to help reduce the deficit). In particular, a Btu energy tax is expected to reduce our demand for imported oil and encourage the development of processes that are less environmentally damaging. Moreover, it can be put in place more rapidly, and with a less costly administrative infrastructure, than can a VAT. In sum, an energy tax is clearly an appropriate item to be considered to cut the deficit, encourage conservation, and reduce dependence on foreign oil.

ADMINISTRATIVE COST OF TAXES

Question: Isn't it more efficient from the government's and taxpayer's perspective to enforce and comply with a single broad-based consumption tax rather than with the maze of taxing systems we currently operate under - the corporate income tax, the individual income tax, the payroll tax system, excise taxes, and a potential energy tax and VAT? (Senator Danforth)

Answer: Although administering a single broad-based consumption tax would be less costly than administering a set of different taxes, the benefits of relying on several different taxes greatly exceed the additional administrative costs incurred. First, the rate of tax for the single consumption tax would have to be much higher than current tax rates if the single tax is to generate the same revenue. Since the distortive aspects of a tax tend to increase more than proportionately with the tax rate, it is likely that the economic losses due to such distortionary effects will be greater for a single tax. Second, reliance on a single tax would subject federal receipts to greater fluctuations due to changing economic conditions. Third, a broad-based consumption tax is inherently regressive, and while it can be made somewhat less regressive through the use of varying tax rates on different goods and services, such mechanism is quite limited and creates significant administrative complexity of its own. On the other hand, by expanding the current earned income tax credit (EITC) provision of the individual income tax, the regressivity of the proposed Btu energy tax can be offset far more effectively. In short, though it is more complex, relying on several different taxes (each with moderately low tax rates) provides greater flexibility and better meets the various objectives of our tax system.

COMPETITIVENESS EFFECTS OF TAXES TO FUND HEALTH CARE REFORM

Question: Has the Administration considered the impact on the competitiveness of U.S. businesses of new taxes needed to fund health care reform? (Senator Danforth)

Answer: Since the Administration's health care program is still being developed, it would be inappropriate at this time to comment on the potential revenues that might be required. Nevertheless, for many U.S. companies, health care currently represents a significant portion of total labor costs. Getting health care costs under control, and limiting the cost-shifting that characterizes our present system of care, is likely to prove very beneficial to U.S. businesses, especially those engaged in international trade.

GATT LEGAL BORDER ADJUSTMENTS FOR ENERGY TAX

Question: Is it possible to design a GATT legal border adjustable energy tax? What would be the features of such a tax and was it considered by the Administration? (Senator Danforth)

Answer: The Administration is considering border adjustments for the energy tax and welcomes suggestions on this issue.

The United States Trade Representative (USTR) believes that border adjustments for the energy tax, such as the import tax included in the House bill, are defensible under GATT.

The rule in the House bill might be problematic if applied to exports. USTR believes, however, that a border adjustment for both imports and exports (i.e., a tax on imports and a rebate on exports) would be defensible if limited to primary, semi-finished, and agricultural products and, in the case of manufactured products, is further limited to the average energy tax on direct energy inputs used in the primary production process. Limiting the rebate on manufactured products to taxes imposed only at the primary (and generally most energy intensive) stage of production would differentiate such an export adjustment from adjustments found to violate GATT because they involve so-called "cascading taxes" on multiple stages of production. In the case of agricultural products, such a limitation is unnecessary because export rebates for agricultural products are legal under GATT.

TAXES APPLIED TO BOTH IMPORTED AND DOMESTICALLY-PRODUCED GOODS

Question: Doesn't it make sense that if we are going to increase taxes, we should do it in a way that applies to both foreign and U.S. produced goods and manufacturers? (Senator Danforth)

Answer: We agree that any excise tax imposed on domestic products should apply equally to imported products. In the case of taxes that are not imposed directly on a product, but instead are embedded in its cost of production, we similarly believe it is appropriate to equalize the tax burden between domestic and imported products to the extent consistent with our international obligations and administrative feasibility.

**RESPONSE OF SECRETARY BENTSEN TO A QUESTION SUBMITTED BY
SENATORS BAUCUS AND HATCH**

TAX BURDENS ON WESTERN AND EASTERN COAL

Question: Is the tax burden on Western coal three times greater than the tax burden on Eastern coal? (Senators Baucus and Hatch)

Answer: Using what we believe to be the appropriate measure of the tax burden on coal, the differential between Eastern and Western coal is quite small.

Most Western coal is low-sulphur, low-ash subbituminous coal, which has a higher moisture content and a lower Btu content than the bituminous coal produced in the East. Because the tax on coal is based on actual Btu content multiplied by the basic tax rate (26.8 cents per million Btu's under the House bill), the average tax on Western subbituminous coal is \$4.67 per ton compared to an average tax of \$6.41 per ton for Eastern bituminous coal.

Almost all Western subbituminous coal production and about 70 percent of Eastern bituminous coal production is used by electric utilities. The most direct competition between Western and Eastern coal is for the Midwestern electric utility market.

On average, the tax on Western subbituminous coal will be about 20 percent of the price paid by utilities, and the tax on Eastern bituminous coal will be about 17.4 percent of the price paid by utilities (using 1991 prices).

The tax, as a percentage of price paid by utilities, is the appropriate measure of the relative tax burdens on Western and Eastern coal.

- Under the House bill, the tax on coal received by an electric utility is passed through to end users in the form of a tax on electricity.
- It is the amount of the tax relative to the price utilities pay for coal that determines the effect of the tax on the competitive position of Western coal relative to Eastern coal.
- As noted above, the tax as a percentage of the price paid by utilities for Western subbituminous coal is only slightly higher than the tax as a percentage of the price utilities pay for Eastern bituminous coal.
- The Department of Energy projects a negligible amount of switching between Eastern and Western coal due to the tax.

RESPONSE OF SECRETARY BENTSEN TO A QUESTION SUBMITTED BY SENATOR HATCH

IMPACT OF ENERGY TAX ON FOUR-PERSON FAMILY

Question: Could Treasury explain the seeming discrepancy among the figures that have been released on the impact of the energy tax on a four-person family? (Senator Hatch)

Answer: There are no discrepancies between the figures Treasury has released on the impact of the energy tax on a four-person family and other data that Treasury has released on the impact of the energy tax and on the impact of the Administration's total revenue proposals. These other data are not for four-person families, and that appears to be the source of the seeming discrepancy.

Treasury has released examples of the impact of the energy tax, when fully phased in, on the direct energy expenditures of a four-person family. (Direct energy expenditures are gasoline, natural gas, home heating oil, and electricity). These examples are based on average direct energy expenditures for four-person families at various income levels and the appropriate fully phased-in tax rates on each energy source. The example for a four-person family with family economic income of \$40,000 shows that beginning July 1, 1996, when the energy tax is fully phased in, the tax on the family's direct energy expenditures would have been \$9.50 per month under the Administration's proposal. (Under the House bill, this figure is \$9.49 per month.)

Treasury has also released a table, a copy of which is enclosed, that shows the average tax change per family per month by income class for the years 1994 through 1997 for the Administration's entire revenue package, including the direct and indirect effects of the energy tax. These monthly averages are for all families in each income class, and not just for four-person families. The table shows that in 1997, when the energy tax is fully phased in, the impact of the Administration's entire revenue package on the average family in the \$30,000 to \$50,000 income class (for which the average income is quite close to \$40,000) will be \$17 per month. This is the figure that President Clinton cited in his State of the Union Address on February 17. This figure is unchanged under the House bill.

Treasury has in addition released its estimates of the total (direct and indirect) impact of the energy tax by region. The attached table provides these regional impact estimates using fully phased-in (July 1, 1996) rates under the Administration's proposal (before modifications by the Ways and Means Committee). The first column of the table shows by Census region the dollar amount of tax that would be paid on a per capita basis. The second column of the table expresses the tax as a per cent of disposable personal income in each region. The third and fourth columns show the same information as the first two columns, but expressed as a percent of the national average. A map showing Census regions and data from the second column follows the table. The first column of the table shows, for example, that in the Mountain Region, which includes Utah, the per capita amount of the energy tax, including all direct and indirect effects, is estimated to be \$104 per year (or \$8.67 per month). The per capita amount is obtained by dividing the total amount of energy tax allocated to the region by the region's total population. The per capita amount cannot be multiplied by the number of persons in a family to obtain a family amount, because energy consumption generally increases more slowly as family size increases.

RESPONSE OF SECRETARY BENTSEN TO A QUESTION SUBMITTED BY SENATOR WALLOP

OIL IMPORTS

Question: Will the energy tax increase oil imports? (Senator Wallop)

Answer: The Department of Energy projects that the energy tax, as amended in the House bill, will reduce oil imports in the year 2000 by more than 350,000 barrels a day.

- Even with the tax, imports will increase, but by a smaller amount.

Oil imports will decrease because the tax will reduce U.S. consumption of oil, without any significant effect on U.S. production of oil.

- Reduced U.S. consumption will lead to a drop in world oil production.
- The drop in world oil production will be either spread uniformly across all producing countries (if OPEC tries to maintain market share) or concentrated in OPEC countries (if OPEC tries to maintain price levels).

[Submitted by Senator Bill Bradley]

BILL BRADLEY
NEW JERSEYCOMMITTEES
FINANCE
ENERGY AND
NATURAL RESOURCES
SPECIAL COMMITTEE ON
AGING

United States Senate

WASHINGTON, DC 20510-3001

April 21, 1993

Dear Colleague:

Much has been said over the past three weeks of debate about how best to promote growth in our economy. I think it is important for us to remember that the most important growth incentive we can pass in this Congress is credible bipartisan deficit reduction. If we continue to pile on debt, we will place a stranglehold on national investment and make the United States a second-rate economic power. The impact will be felt most strongly by our children and our grandchildren. Unless we get our fiscal house in order, GAO has warned, all of our incomes (per capita GNP) will be 40 percent lower in the year 2020 than they otherwise could be.

The President's economic package is a positive first step in returning our nation to fiscal sanity, and I support it. But I think that we can and should improve upon the President's proposal by eliminating the incremental investment tax credit for large corporations and the permanent investment tax credit for small businesses, and applying the proceeds either to further reduce the deficit or to lower the top corporate tax rate. I am writing to enlist your support for such a change during the reconciliation process.

The corporate side of the President's package takes from one class of corporations and gives to another. While we would raise \$31 billion by increasing the top corporate rate to 36 percent, we would give \$29.5 billion back through the ITCs. Such corporate redistribution will not stimulate our economy in aggregate. And to the extent that it is paid for either through lower deficit reduction or higher corporate rates, it will actually harm our economy.

First, only a narrow range of companies will benefit from the ITCs. \$29.5 billion is a lot to pay for loopholes that nobody really wants. Investment tax credits favor companies that invest in equipment over those that invest in their workers, e.g. through retraining programs. They favor companies in manufacturing industries over those in service and trade industries. They favor older established businesses over new, entrepreneurial ventures. They favor companies that can adjust their plans and shift their investments around over those that have a steady rate of investment. Most of corporate America would rather we quit playing favorites and keep their tax rates down or at least make a downpayment on our staggering national debt.

Second, neither of the credits will stimulate net long-term investment. Throughout the long history of the ITCs, one fact has remained true -- business men and women in America will acquire machinery and equipment only if it makes good business sense; they won't invest simply to get a tax credit. Although they may appreciate the extra money in

their pockets at the end of the day, let's not fool ourselves into thinking that we will really be affecting behavior.

Moreover, the credits themselves are extremely limited. The permanent credit applies only to firms with "gross receipts" under \$5 million, and even then, the maximum credit in the out-years would only be 5 percent. Most of these firms are already tax-favored. A recent report by Jane Gravelle of the Congressional Research Service indicated that under current law the tax rate for large corporations on corporate capital invested in equipment is twice the rate faced by unincorporated small businesses. And even if we pass this credit, the fact is that most of the investment in plant and equipment will still be made by firms larger than \$5 million.

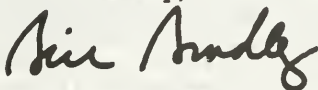
The problems with the temporary, incremental credit are even more pronounced. A temporary credit will have no effect on long-term employment. Indeed, the primary effect of opening a window like this will be to create a short flurry of activity followed by an immediate period of lower investment -- a "feel-good today, pay tomorrow" approach. And we all know the pressure that arises to extend such "temporary" provisions when they fail to meet their immediate goals. The primary effect of an incremental credit will be to reward those companies who have let their investments lag and punish those who have maintained their investment.

Finally, these provisions will simply add complexity and distortion to the tax code and open up opportunities for tax shelters. The fact that we have yet to see final proposals from the Administration is a testament to the complexity involved in writing these provisions. How will "qualifying property" be defined? What "anti-abuse" provisions will be included? How will "base-periods" for new corporations be defined? These proposals may end up being a full-employment act for tax lawyers and accountants.

The bottom-line question is who is to decide where our assets can most productively be placed. Anyone who supports the ITCs is gambling on the notion that Congress is better at allocating our scarce resources than markets are. You cannot in one breath talk about the vitality of the private sector and in the next breath be calling for narrowly targeted tax breaks.

I plan to offer an amendment during the reconciliation process that will strike these provisions. Instead of spending \$29.5 billion for narrow incentives opposed by the vast majority of corporations, we should be applying those funds either to deficit reduction -- to free up \$29.5 billion in capital for the entire private sector, or to lowering the top corporate rate -- thereby benefiting all corporations equally. I hope you will join me in this effort. Please call Michael Dahl on my staff at 4-3224 for further information.

Sincerely,



Bill Bradley

PREPARED STATEMENT OF JOHN G. BUCKLEY

I. Summary

The New England Fuel Institute ("NEFI"), the Empire State Petroleum Association ("ESPA"), the Fuel Merchants Association of New Jersey ("FMA"), the Oregon Petroleum Marketers Association ("OPMA"), the Michigan Marketers Association, ("MMA"), the Delaware Valley Fuel Oil Dealers Association (Delaware, Pennsylvania) ("Delaware Valley"), and the Minnesota Petroleum Association ("MPA") have joined in support of changes to the Administration's proposed Btu tax that affect the heating oil industry and its 12 million consumers nationwide. The heating oil industry is composed primarily of thousands of small, mostly family owned local enterprises. These firms sell "home heating oil" to residences, non-profit institutions, municipalities, businesses, and farmers. They sell No. 2 distillate, kerosene, on-highway diesel and residual fuel oil. The foregoing associations alone represent more than 3,500 such small heating oil marketers that are not affiliated with any integrated oil company.

While the consumers of heating oil are primarily residential, more than one-half million such consumers are not homeowners. In every heating oil state, there are many thousands of schools, hospitals, churches, apartments, businesses and municipalities that use oil for heat and hot water. In addition, while most oil used for heat is No. 2 fuel oil, commonly called home heating oil, a significant amount of kerosene and residual fuel oil is also used for home heating purposes.

The Treasury proposal, as modified, would exempt only residential consumers of home heating oil from the supplemental tax, thereby imposing on residential consumers of other petroleum fuels and on all non-residential users of heating oil the supplemental Btu tax rate of 59.9 cents/MMBtu, almost 2 1/2 times the rate imposed on other consumers.

While the amended proposal is an improvement on Treasury's initial recommendation, the supplemental Btu tax should not apply to any consumer of heating oil, whether purely residential, mixed use, public sector, non-profit, agricultural or commercial. Further, the supplemental tax should not apply to any of the heating fuels, whether No. 2 distillate, kerosene or Nos. 4 and 6 residual fuel. The distinctions established by the amended proposal have no equitable basis and would impose major differences in tax burdens on similarly situated consumers.

While the foregoing changes would treat all heating fuels consumers fairly, the exemption would be more equitable and enforceable if it encompassed all off-highway distillate which, after October 1, 1993, will be a different fuel physically than No. 2 diesel for highway purposes and will be dyed blue pursuant to Clean Air Act requirements. This exemption could be more easily administered and would spare all heating oil users and farmers the burden of the supplemental tax.

Even with this change, the supplemental Btu tax would impose a harsh penalty on domestic manufacturers, transporters and utilities that must rely on petroleum products other than off-highway distillate. It may even have the perverse effect of increasing our balance of payments deficit and will have no noticeable impact on our energy security. Accordingly, the Btu tax would be simpler, fairer, more regionally balanced and less economically destructive if the same rate were applied to all users of all fuels.

II. The Treasury Proposal for Heating Oil

As originally proposed by the Administration, the Btu tax would have imposed a rate of 59.9 cents/MMBtu on oil consumers, compared to 25.7 cents/MMBtu for all other energy users. The impact on the end-user would be increases of 9 to 12 percent on heating oil, 23 to 25 percent on residual fuel, about 12 percent on farm diesel, and only 3 to 5 percent on natural gas and only 3 percent on electricity. Both the Senate and the Treasury have recognized the harshness of this disparity and have moved to correct it. The Senate, in an amendment to the Budget Resolution; and the Treasury, in a change only partly responsive to the Senate action.

A. Exclusion of Non-Residential Consumers

On March 24, 1993, the Senate adopted a "Sense of the Senate" amendment, sponsored by Senators Kennedy, Mitchell, and others, specifically stating that fuels used for home heating purposes should be exempted from the supplemental Btu tax on oil. The "Sense of the Senate" amendment was intended by its sponsor to apply to all users of heating oil, even though commonly called "home heating oil" users. Senator Kennedy specifically pointed out the inequity of imposing the higher rate on such institutions as schools, colleges, and hospitals. The Treasury modification would exempt "home heating oil" from the supplemental rate, but apparently would define the term so narrowly as to exclude all "non-residential" fuel use of home heating oil, to which it would apply a "use tax."

Treasury proposes that the person using the product would be liable for the tax and would remit the tax directly to the government. This would impose a new federal excise tax obligation on every school, hospital, church, local government, store, business or doctor's office that uses oil for heat. As a result, more than 1/2 million "commercial" oil heat users would become federal excise taxpayers.^{1/} Even with the taxation of residential heating oil at the basic rate of 25.7 cents/MMBtu, Treasury points out that the two census regions with the highest tax per capita remain New England and the mid-Atlantic, at 112 and 104 percent of the national average. As graphically depicted in Attachment 1, expansion of the exclusion to all users of heating fuels will certainly bring these two regions closer to the national average.

B. Exclusion of Residential Kerosene

In the debate on the Kennedy amendment, Senator Mitchell made clear that it applied to all oil derived home heating fuels, including kerosene and propane. The modification announced by the Treasury on April 1, 1993, would exempt only residential "home heating oil" from the supplemental tax. This step is unduly restrictive, particularly as the tax affects the rural poor. If the burden on low-income households is to be ameliorated, it is essential that the supplemental tax not be applied to kerosene used for home heating. The cost of excluding such kerosene users from the supplemental tax would be about \$22 million/year.

The Economic Opportunity Research Institute recently analyzed the President's proposed Btu tax and its impact on the poor. The study concludes that the tax would raise residential

1/ In addition, from 1 to 2 million multi-family units that use residual fuel, considered commercial, may be subject to the supplemental tax.

energy costs for low-income households by more than \$1 billion per year. The study concludes that the tax would be most burdensome in areas where home heating oil consumers also drive, particularly in the less densely populated parts of New England, New York, the upper Mid-West, and certain parts of the Pacific Northwest. The average direct impact of the tax on low-income households in these areas would range from \$138 to \$158 per year and in some cases could be double that amount.^{2/}

A significant portion of this burden on low-income households has been lifted by the modification announced by the Treasury on April 1, 1993. However, much of this burden remains, primarily because rural, poor households, particularly in very cold areas, often use kerosene or propane for home heating, sometimes in combination with No. 2 heating oil.

III. The Proper Scope of the Heating Oil Exemption

From the perspective of fairness as well as effective administration and enforcement, all heating oils should be subjected to the same tax rate as other heating fuels, such as coal, electricity or natural gas. Users of all petroleum products for heating, whether kerosene, No. 2 distillate oil, or Nos. 4 and 6 residual oil should be taxed at the same rate per MMBtu. If the base rate is applied to all heating fuels, the percentage increase in end-user prices would be from 3 to 10 for heating oils, compared to 3 to 5 for residential gas and electricity.

There should be no distinction for residential or non-residential use. An apartment house in Brooklyn that uses residual fuel or a rural residence in Maine that blends its No. 2 oil with kerosene should pay the same rate as the homeowner using No. 2 distillate, electricity, natural gas or anthracite coal. Further, the local church, library, business or store, doctor or dentist office, and police or fire station should pay the same rate for heating fuel as do similarly situated consumers in other regions that use other fuels. To distinguish among those consumers is unfair and an administrative impossibility. The cost of exempting all of these users from the supplemental tax is about \$250 million/year, assuming that compliance by all such users with the supplemental tax obligation would be 100 percent.

The Treasury recognizes that it is administratively impossible to impose the supplemental tax upstream of the end-user on some consumers of heating oil but not others. Whether the collection point is located at the refinery gate or the terminal rack, there can be no segregation of fuel destined for residential versus non-residential use, because it is delivered in the same truck by the same marketer.^{3/} The only alternative is to impose the supplemental tax directly on the non-residential end-user, which is not only burdensome but administratively unworkable. There are millions of these consumers, primarily public sector, non-profit and small business users who are not currently federal excise taxpayers. A massive education and promotional effort would be needed simply to inform these

2/ A copy of the report by the Economic Opportunity Research Institute is submitted to the Committee for its record.

3/ In many instances, it is not possible even for the retail marketer to determine what portion is "residential" and what portion is "non-residential": for example, a doctor's office in his home; a farmer's residence on his farm; or an apartment above a store.

consumers of their new taxpaying obligations. The imposition of the tax on hundreds of thousands of end-users also would violate Treasury's cardinal enforcement principle that excise taxes should be imposed at a point where there is a small and easily auditable set of taxpayers.

These problems of equity and administration can be ameliorated by exempting all off-highway distillate from the supplemental tax. Beginning on October 1, 1993, off-highway distillate will be dyed blue pursuant to Clean Air Act requirements.^{4/} After that date, diesel fuel for highway use must meet an ultra low sulphur requirement of .05 percent and, for the first time, will be a different product physically than "heating oil." Although most off-highway distillate is used for heating purposes, both residential and commercial, it is also used for farm, industrial, railroad, vessel, and electric utility uses. Approximately 55 percent of off-highway distillate is used as heating oil, but 7 percent is used by farmers, 10 percent by industry, 13 percent by railroads, and 2 to 3 percent by utilities. The cost of exempting all off-highway distillate from the supplemental tax would be about \$500 million per year more than the cost of exempting heating oil alone.

Constructing the exemption in this way would utilize the same distinction that currently exists for taxable diesel fuel and non-taxable distillate. It would permit the wholesale distributor, which must segregate these products and collect the tax, to distinguish between products destined for uses subject only to the base tax and uses subject to the supplemental tax and the diesel excise tax. This distinction also would ease enforcement complexities, because clear fuel would be subject to the supplemental tax and dyed fuel would not.^{5/} The exemption for all off-highway distillate also would lessen the tax burden on farmers and further reduce the inequity imposed on the New England and Mid-Atlantic regions resulting from their much higher use of distillate for industry and electric power generation.

IV. The Supplemental Tax Should Not be Imposed on Residual Fuel

Residual fuel oil is used primarily by three types of consumers: industrial, electric utility and apartment house. The supplemental tax should not be imposed on residual fuel for any of these uses. First, a supplemental tax on industrial use will severely handicap the competitiveness of industries that use oil. Not only will these industries be impaired internationally, but they will be restricted in their competition with firms in other regions that are not subject to the supplemental tax.

A case in point is the pulp and paper industry. In Maine, New Hampshire, upstate New York, and western Pennsylvania, this industry runs on residual fuel. In most cases, there is no alternate fuel available. These firms compete with Canadian pulp and paper mills, which will not bear any of these taxes. Many of these U.S. mills use between 1 and 2 million barrels of resid annually; therefore, a tax of about \$3.68 per barrel will be a very onerous cost burden. Moreover, once the inflation index begins to escalate this tax further, there will be no way that these mills can remain competitive against Canadian competition.

4/ Section 211(i) of the Clean Air Act of 1990, P.L. 101-549.

5/ There will be instances in which clear distillate would be used for heating purposes. In such circumstances, a credit or refund mechanism must be established for off-highway users of clear distillate.

In varying degrees, this same handicap will be imposed on the chemical industry, the steel industry and others. The resulting decline in our industrial base will further erode the balance of payments and employment.

The Administration has properly exempted refinery fuel by taxing the product output of the refinery rather than the crude oil input to the refinery. This change eliminates a competitive advantage that would have been enjoyed by imported petroleum products because their production is not subject to the Btu tax. This same logic dictates that the supplemental tax not be imposed on any industrial production. The tax provides too significant an incentive to import products that are not subject to an energy tax and therefore are less costly, particularly from Canada and, after NAFTA, from Mexico.

The supplemental tax would place an equally inappropriate burden on electric utilities that use residual fuel; and it would create a severe regional inequity. Only 3 percent of electric power generation nationwide is fueled by oil, but about 25 percent in New England and 20 percent in New York/New Jersey. Thus, the supplemental tax will impose a penalty only on consumers in these regions, with little or no net benefit. In periods of high demand, these utilities must use oil because pipeline capacity limits the availability of gas. For this reason alone, it is essential that the residual fuel marketing sector remain viable. Further, the residual fuel oil used in most of the Northeast is ultra low sulphur and, therefore, almost environmentally benign.

The supplemental tax on residual fuel will also threaten the viability of simple domestic refineries with a high output of this product. These refiners will be unable to recoup the supplemental tax on residual fuel because it will not be imposed on competitive fuels, like coal or natural gas. Unless they can pass through the tax to other refined products,^{5/} this "squeeze" will lead to downward pressure on the price of the heavy crudes used by these refiners. In California, where heavy crude oil production is dependent on residual fuel oil refineries as customers, this pressure will likely lead to less domestic oil production and increased imports of crude oil.

Although the Btu tax is designed to distribute burdens relatively evenly, a supplemental tax applied to residual fuel would impose by far the highest percentage price increase on any end-users of any fuel, adding approximately 25 percent to the price for large industrial or electric utility users! Because of this very large cost differential, the supplemental tax has virtually the same effect as an oil import fee to these users and the regions in which they operate. The retention of the supplemental tax on residual fuel oil would impose a heavy penalty on manufacturers, utility consumers and apartment residents in these regions, with little or no net benefit; and, in most cases, on users with no economic alternatives.

V. The Supplemental Tax Should be Eliminated

The supplemental tax creates equally compelling difficulties for other oil consuming industries. The aviation industry, for example, which has lost about \$10.8 billion over the last 3 years, has no choice but to use petroleum. The imposition of a supplemental tax on aviation fuel, together with the base tax,

^{5/} It is not likely that the tax could be shifted to users of other petroleum products, because imported products will be available with only the proper allocable portion of the BTU tax imposed.

will add more than .5 billion in costs to our domestic airlines, and may further diminish the shrinking number of operating carriers.

All of these problems are real and merit the Committee's specific attention. One solution is to lace the supplemental tax with a myriad of exemptions and special provisions, each of which is meritorious, if not compelling. However, a far better solution is to eliminate the supplemental tax entirely, and avoid enacting a tax with a host of exemptions that still creates a series of secondary impacts on competition, jobs, refinery output, and crude oil production. Elimination of the supplemental tax resolves many anti-competitive and distributional inequities. It recognizes that the Btu tax is an economic deficit reduction measure, rather than a new, half-formed and ill-considered energy policy. The failure of the supplemental tax to accomplish its stated goals, and its adverse impact regionally and competitively, are the subject of a report by the Petroleum Industry Research Foundation, Inc.: "Oil and the Btu Tax: Still Time for Re-design." A copy of this report is submitted to the Committee for its record.

Elimination of the supplemental tax would place the same Btu tax burden on all energy consumers, wherever they reside and whatever fuel they consume. The percentage price increases on end-users -- the ultimate taxpayers -- would range from 3 to 5 percent on heating oil to 10 percent on residual fuel. Energy efficiency would be rewarded, while high energy consumption would be penalized. Markets and interfuel competition would not be distorted. Elimination of the supplemental tax would have no noticeable impact on national security, balance of trade or the achievement of environmental goals, its only justifications.

VI. Simple and Familiar Collection System

Whatever the scope of the heating oil exemption, Congress should attempt to establish a collection system that is relatively simple and draws upon the current excise tax system, providing taxpayers with a familiar method of collection. With a new collection program, there is often substantial confusion. A simple and familiar system minimizes these difficulties and enhances compliance.

One appropriate means of collecting the Btu tax would be to impose that tax at the terminal rack. On dyed fuel, the terminal operator would serve as the taxpayer for the basic Btu tax of 25.7 cents per million Btus. The supplemental Btu tax of 34.2 cents per million Btus would be collected, where appropriate, by marketers purchasing from the terminal who are registered with the Internal Revenue Service and already serve as taxpayers under the Federal Excise Tax Program for diesel fuel. On clear fuel, the Btu tax of 59.9 cents per million Btus would be imposed at the terminal rack, and the terminal operator would serve as the taxpayer.

An alternate approach would be to (1) impose the basic Btu tax of 25.7 cents per/MMBtu's at the refinery gate; (2) move the Federal excise tax on diesel fuel to the terminal rack; and (3) exempt all off-highway distillate fuel oil from the supplemental Btu tax. Under this scenario, in most cases, both the basic and the supplemental tax, as well as the Federal excise tax, would be imposed on clear fuel. However, only the basic Btu tax would be imposed on dyed fuel.

This system would offset any lost revenue due to expanding the exemption from the supplemental tax; moving the collection point for the Federal excise tax on diesel fuel up the distribution chain to the terminal rack would generate compensating increased revenues, estimated to be more than \$100 million per year.

Attachment 2 sets forth in more detail the two proposals discussed above.

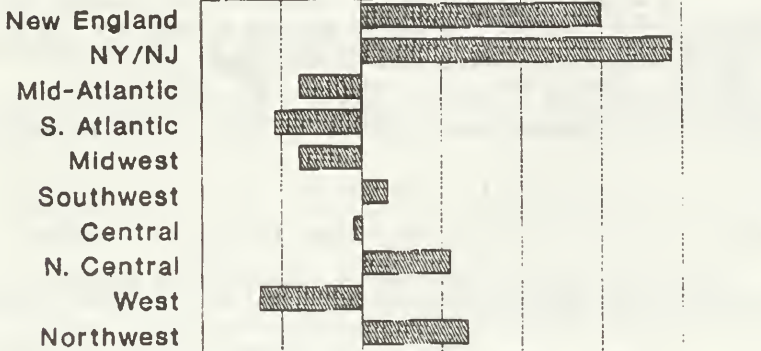
VII. Conclusion

It is difficult for us to support any Btu tax. However, in order to assist in the laudable goal of deficit reduction, we can endorse a uniform Btu tax or an ad valorem tax that places the same burden on all fuels and comparable price increases for all end-users. This should be the primary design goal of this energy tax. The Administration's "modified Btu tax" does not meet this test. The Btu tax can be preserved and improved by equalizing the tax on all fuels. If a Btu tax is to be enacted, Congress has the opportunity to craft it in a way that is regionally fair and imposes an equitable burden on similarly situated consumers. We strongly recommend adoption of the changes necessary to accomplish these goals.

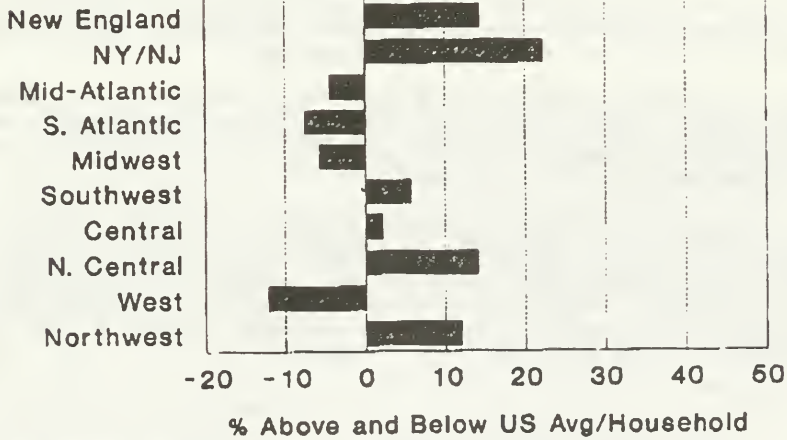
Attachments

Indirect Burden of the BTU Tax Taxes on Commercial Energy Compared

BTU Tax as Proposed



No Supplemental Tax on Heating Fuels



Example 1

- Impose the Btu tax at the terminal rack.
- The terminal operator would remit to the IRS only 25.7 cents per million Btus on sales of dyed fuel.
- The terminal operator would remit the tax of 59.9 cents per million Btus on the sale of clear fuel.
- A marketer (a registered "wholesale distributor" that holds a 637 Certificate of Registry bearing a suffix of "UL") purchasing dyed fuel at the rack would sell the fuel to either to (1) another registered "wholesale distributor" with a 637 Certificate, bearing the suffix of "UL", (2) a heating oil retailer (a marketer registered with the IRS and holding a 637 Certificate of Registry with a suffix of "L") or (3) an end-user.
- If the original registered marketer were to sell the dyed fuel to another registered marketer (with a certificate bearing the suffix "UL"), no additional tax would be imposed.
- If the original registered marketer sold the dyed fuel to a heating oil retailer holding a 637 certificate with a suffix of "L", no additional tax would be imposed.
- If the original registered marketer sold the dyed fuel to an end-user that is exempt, such as a homeowner, no additional tax would be imposed.
- If the original registered marketer sold the dyed fuel to an end-user that uses the fuel for a non-exempt purpose, the registered marketer would serve as the taxpayer and would remit the 34.2 cents per million Btus to the IRS.
- If a registered marketer were to buy clear fuel at the rack (fuel with a sulphur content of .05 percent by weight), and the marketer declared that the fuel would be used for a tax exempt purpose, dye would be added at the rack and no supplemental Btu tax would apply.
- If a registered marketer were to sell clear fuel, on which the tax has been paid, to a homeowner or other consumer using the fuel for a tax-exempt purpose, there must be a credit or refund mechanism available for the marketer to minimize cash flow problems. This credit/refund would only be permitted if the marketer can demonstrate to the satisfaction of the IRS that the transaction for the exempt use occurred.

* * *

This proposal assumes that the Federal excise tax on diesel fuel remains at its current level -- at the point of use when a registered wholesale distributor determines whether the fuel will be used for taxable or tax-exempt purposes.

Example 2

- This example assumes that all off-highway distillate fuel is exempt from the supplemental tax of 34.2 cents per million Btus.

- This example also assumes that the Federal excise tax for diesel fuel is imposed at the terminal rack. (This assumption would change current law).

- Impose the basic Btu tax of 25.7 cents per million Btus at the refinery gate and have the refiner serve as the taxpayer.

- Assume that product moves to a terminal rack; clear fuel would be subject to two additional taxes--the supplemental tax of 34.2 cents per million Btus and the Federal excise tax of 20.1 cents per gallon. The terminal operator would serve as the taxpayer.

- Assume that product moves to a terminal rack; dyed fuel would not be subject to any additional tax.

- If distillate fuel that contains .05 percent sulfur by weight (typically known as low sulfur fuel) is to be used for an exempt off-highway purpose, the marketer purchasing the product at the rack would have to indicate that purpose and the fuel would be dyed before it left the rack and no additional tax would be imposed.

- If a marketer were to sell clear fuel on which tax has been paid to an exempt user, there must be a credit or refund mechanism available for the marketer to minimize cash flow problems. This credit/refund would only be permitted if the marketer can demonstrate to the satisfaction of the IRS that the transaction for the exempt use occurred.

PREPARED STATEMENT OF ROBERT B. CATELL

I. INTRODUCTION AND SUMMARY

Thank you Mr. Chairman and distinguished members of this Committee. I am Robert B. Catell, president & ceo of The Brooklyn Union Gas Company (BUG). BUG is primarily engaged in the distribution of natural gas to 1.1 million customers in a New York area comprising 4 million people. We are also engaged in the production and exploration of natural gas and the cogeneration of power. I am pleased to be here today on behalf of the Natural Gas Council (Council), a coalition which includes the American Gas Association, the Independent Petroleum Association of America, the Interstate Natural Gas Association of America and the Natural Gas Supply Association, representing all segments of the natural gas industry--distributors (utilities), pipelines and producers. We welcome this opportunity to present our views concerning the Administration's proposed energy tax.

The Council strongly supports the President's commitment to curtail federal spending, reduce the deficit and promote economic growth. The natural gas industry is encouraged by the Administration's expressed desire for greater use of clean-burning natural gas. This increased reliance on natural gas will reduce our dependence on imported oil and improve our environment. These goals can only be met if there are healthy and growing companies in all segments of the industry.

In a letter to the President, the members of the Council stated that they are on record as not supporting energy taxes, but pledged to work constructively with the appropriate individuals within the Administration on unresolved issues in the economic package. We believe there are more effective means for achieving the Administration's policy goals, such as a broad-based consumption tax. The members of the Council agree that the Btu tax on natural gas should be imposed on the end-user of the gas and collected by the last seller of that gas. Given the size and complexity of the proposed energy tax, it is essential that the tax does not inadvertently become through faulty structuring, a tax on the production, transmission or distribution of gas. The proposed Btu tax should be structured as an excise retail tax levied on the consumption of gas by the ultimate consumer in the same manner as the federal excise tax on telephone service.

The Administration's proposal to collect the tax on natural gas at the city-gate or out of the pipeline threatens the well-being of gas companies, particularly gas utilities which may be denied full and immediate flow through of the tax. The Btu tax could equal or exceed the annual net incomes of a majority of gas utility companies. This impact on utilities would adversely affect every segment of the natural gas industry and its customers. The tax would also hit low-income consumers particularly hard and adversely affect job growth, the economy and impair global competitiveness.

When the Btu tax was initially conceptualized, there was some thought that it could promote energy security and environmental goals. As the tax developed and exemptions and changes were proposed, the environmental and energy security goals appear to have been lost. In some applications, the tax would work against these goals.

Collecting the tax upstream from the retail level will increase the tax burden in some states by as much as 15 percent because of piggyback taxes and another 10 percent for taxing gas that is stored, unaccounted for, lost or used to maintain pressure and gas flow in pipelines. These costs would be in addition to the \$310 we estimate the average household would incur because of the Btu tax on energy. In addition, the point of collection for the tax may very well slow the deployment of clean, efficient and domestically manufactured energy technologies, since companies that have historically marketed these technologies might not obtain effective flow through of the costs.

Moreover, as a result of industry restructuring, there is no longer a clearly definable "city-gate" in the natural gas industry. More importantly, given the number of pipeline to pipeline transfers involved in transporting gas, including small diameter, short distance pipe that delivers gas to many end-users, there is the potential for some to avoid paying the tax collected at the city-gate. Further, under FERC Order 636,¹ pipelines own little or none of the gas they transport to the utility system. Thus, the city-gate collection point becomes difficult because neither entity has title to the gas. Indeed, for much of the gas delivered to the utility, for which the utility is just a transporter, the pipeline and utility do not have contractual privity. The utility merely delivers the gas it receives to the customer-owner; the utility has no role in regulating the amount of gas delivered to it. There is no basis for the pipeline to bill the utility for these quantities.

Imposing the tax upon the end-user would minimize the administrative and operational burdens of the tax, ensure that all sources of gas, both domestic and imported, are treated equally and avoid conflicts with other important governmental policies. Collecting the tax from the ultimate consumer would best achieve the Administration's goals of generating revenue from the users of energy, levying the tax on consumption and flowing the tax through to customers.

The collection of the tax at any other point, including the wellhead, pipeline or city-gate, will result in higher administrative costs, compounding of state and local sales and gross receipts taxes onto the Btu tax (we estimate these taxes would cost gas consumers an additional \$350 to \$400 million annually and gas and electric customers together \$1.05 billion to \$1.2 billion once the tax is fully phased in), greater risk of tax avoidance and market distortions. There would be considerable risk that not all the tax would be passed through to consumers leaving utilities with stranded costs. It would be tragic if the Btu tax were imposed in such a manner that domestic gas supplies are reduced or the industry's ability to transport and distribute gas is impaired.

While some in Congress may be reluctant to see the Btu tax appear on the customer's bill as an excise tax, some state PUCs will require disclosure regardless of where or how the tax is collected. Further, gas company CEOs advise us, for prudent business purposes, that they will inform their customers of the tax to explain the reason behind the increase in the customers' bills. In addition, resulting rate cases will bring greater public and media attention to the tax.

The Council opposes the exemption of methanol and ethanol from the tax. All alternative transportation fuels should be treated the same or distortions will occur in the alternative fuels market.

¹ The Federal Energy Regulatory Commission issued Order Nos. 636, 636A and 636B that provide for a major restructuring of the way interstate natural gas pipelines work. The impetus behind the major restructuring rule is to ensure that gas buyers have greater access to the competitive wellhead market. As a result, pipelines are allowed for the first time to sell gas at negotiated rates in a manner similar to the way re-regulated companies sell gas. The central feature of the restructuring rule is the unbundling of interstate pipeline sales and transportation services. However, pipelines are permitted to offer sales and transportation services in a repackaged format if the rate for each service is separately stated.

City-Gate Collection Point

The Council strongly urges that the collection point be moved to the end-user. If not, there are serious problems that must be addressed. First, gas utilities should be required to pay to the pipeline for remittance to Treasury only what they collect from the end-user.

Second, utilities should be permitted to recover the tax in customer rates. This will require some legislation directing state public utility commissions (PUCs) to allow utilities to flow through the tax. The Administration has proposed that a utility be denied its tax benefits under normalization if the energy tax is not passed through. Our concern is that this mechanism is neither a sufficient nor fair way of encouraging state PUCs to flow through the tax, since the size of the tax could exceed the benefits gained from normalization. In addition, the utility could be penalized twice under this proposal, once in the absorption of the tax and again in the denial of normalization benefits.

Third, we urge Congress to add legislative language to address the problem of double taxation or compounding of taxes. Such language should provide that revenues from recoupment of the Btu tax is excluded from any form of federal, state, local or other taxation.

II. IMPACT OF THE TAX

1. Households

For the average gas-heated household, we estimate the tax would eventually add \$25 to the annual bill, roughly \$23 to the electric bill. The average household would also pay an additional \$76 annually on gasoline consumption. We estimate that the total average household energy costs for a natural gas heated home would rise by \$124 per year. An additional \$184 in increased annual costs per household would be hidden in the costs of all goods and services that rely on energy as they are made or delivered. We estimate that the total average household cost would be nearly \$310 per year. Larger households would pay even more.

Moreover, the national average numbers hide the higher effects upon particular regions, especially the northern states with colder winters. According to the Department of Energy, cold weather regions use as much as 55 percent more energy in homes than warm regions. In colder regions, such as Chicago, the tax would add \$38 to \$44 to a typical gas bill, rather than the \$24 national average.

2. Utilities

If portions of this tax fell upon natural gas companies because of the collection mechanism, the damage could be significant. Some utilities might have to borrow money to replace funds that would otherwise be used as working capital to pay the tax during the period the utility seek to have the tax included in consumer rates by the state PUC (regulatory lag period). Other companies may be required to absorb portions of the tax, which could cripple operations. This could cause a reduction in capital spending. Given the importance of utility capital spending to the economy as a whole, such a reduction could impede economic recovery. Further, an increase in rates to satisfy reducing the magnitude of the tax is so large that it might not receive approval for flow through in a state rate case.

3. Producers

Natural gas producers are in no position to absorb any part of the Btu tax. After years of low wellhead prices, producers are strapped for the investment capital needed to drill the new gas wells the country will need in the near term. The current Solleman Brothers Natural Gas Report projects the U.S. will need between 500 and 600 rigs drilling each week for natural gas to meet expected demand increases. Wellhead revenues are the primary source for drilling capital today. The proposed Btu tax would exceed the net earnings of even the most efficient gas producers and is probably several times greater than the profit the average producer earns on production.

4. Pipelines

From the perspectives of both debt and equity holders, interstate pipelines can ill afford to incur costs that cannot be flowed through to consumers. Over the long term, pipeline stock prices and actual return on equity (declining from 10.1 percent in 1985 to 8.1 percent in 1991) have suffered from the move to open access transpor-

tation mandated by the Federal Energy Regulatory Commission (FERC).² Moreover, the bond ratings have declined from their high of A- in 1984 to a BBB- rating for the 15 major interstate pipelines at the end of February, 1993.

III. WHY END-USER IS MOST APPROPRIATE COLLECTION POINT FOR NATURAL GAS

A. Criteria In Selecting Collection Point

The primary focus of the Council's comments is on structuring the tax on natural gas in a manner that is most practical and least disruptive and burdensome for all segments of the natural gas industry. The Council believes that such an approach would best achieve the federal government's net revenue, conservation and environmental goals.

The primary issues for both the Administration and industry revolve around the related concepts of: (1) who is the taxpayer; (2) where is the point of taxation; and, (3) who serves as the collection agent for the government. The effort to resolve these issues should also include the following objectives: (1) maximizing the collection of the tax and discouraging tax avoidance; (2) minimizing the administrative burdens on both the industry and government, particularly complexities arising upstream, such as piggyback taxes, administration of non-fuel use exemptions and timing problems associated with gas storage; (3) providing for full and immediate flow through of costs to consumers, while minimizing regulatory lag; (4) ensuring that domestic natural gas suppliers, marketers and transporters can fairly compete with their foreign competitors; and, (5) preventing conflicts with other important government policies.

B. Analysis of Criteria in Selecting Collection Point

Based on the considerations above, and for reasons discussed below, the only practical approach to structuring the tax on natural gas is by imposing it on the end-user of the fuel (taxpayer) at the burner tip (point of taxation), with collection by the last seller of that gas (i.e., the local utility, pipeline or other supplier).

1. Ease and Simplicity in Collection of Tax

The point of imposition for the Btu tax should be evaluated in terms of its ease of collection, simplicity and tax avoidance. A retail-level tax on gas delivered to the ultimate consumer is the most appropriate collection point option which meets these requirements. Such a tax would be collected primarily by local utilities and added to the bill of each customer. Because most gas utilities have computerized billing systems and are already structured to collect state sales taxes, the tax could be implemented efficiently. Other sellers to end-users (i.e. marketers) also have sophisticated billing systems capable of collecting a Btu tax. An excise tax on gas would mirror what is currently done with the telephone excise tax.

Collection at this point reduces the number of remitters such that compliance with and enforcement of the Btu tax would be improved significantly. This location restricts the size of the audit universe for the federal government that otherwise expands in the case of upstream tax collection points due to the large number of producers.

Choosing the city-gate as the collection point fails to meet this criteria. A tax on gas utilities at the city-gate only accounts for nearly 60 percent of natural gas consumed in the U.S. The remaining 40 percent consists of thousands of relatively small transactions involving primarily custody but not title changes in gas.

Imposing the tax at any point along the pipeline, entrance or exit, also fails this criteria. Taxing natural gas at the point-of-entry would require a massive tracking system that would be difficult to manage and measure for accuracy while creating much complexity and confusion. A natural gas purchase will typically consist of many individual transactions, such as between the producer and shipper (person arranging deal if the ultimate consumer does not do so), shipper and ultimate consumer, shipper and pipeline, shipper and storage owner, shipper and other shippers, pipeline and an upstream or downstream pipeline and shipper and other customers. Because of restructuring under Order 636, interstate pipelines will no longer buy or sell virtually any of the gas that goes through their pipelines or have knowledge of the actual end-user or end-use.

Another problem with imposing the tax at the point gas is injected into the pipeline is that the tax would be imposed on top of a transportation charge instead of

²The FERC orders for open access transportation, changes in facility and service certification, and rules to allow pipelines to sell gas at negotiated rates, while providing gas buyers with greater access to a competitive wellhead market—have resulted in market forces replacing regulation as the principal factor affecting industry pricing and operations.

the gas cost. This might not only create administrative and tax avoidance problems, it might also subject the tax to regulatory review.

Collection of the tax at the wellhead creates problems as well. Since there are over 280,000 producing natural gas wells and thousands of independent and integrated oil and gas exploration and production companies in the U.S., such a large number of producers invites difficulties with collection and administration of the tax and problems of tax avoidance.

Measurement of the Btu content of natural gas at the wellhead is inefficient and inaccurate. When natural gas is produced, it is either wet (contains liquid by-products) or dry (no liquid products). A tax imposed at the wellhead would create wide disparities in tax rate from well to well. Most natural gas wells do not have Btu measurement devices in place at the point of production.

2. Minimizing Administrative Burdens

Imposing the tax at the end-user level avoids many of the problems associated with collecting it upstream. First, administering the proposed feedstock exemption and other non-fuel use exemptions would be difficult to administer at any point above the end-user level. The Administration's proposal would allow for a natural gas feedstock exemption (natural gas used by the buyer for non-fuel purposes) from the Btu tax. Because of restructuring in the natural gas industry, pipeline operators rarely know the end-use of the gas they are transporting. If the tax is collected at the wellhead, it would be difficult to administer the feedstock exemption. The seller to the ultimate buyer is in the best position to know whether the natural gas would have a non-fuel use and thus qualify for this feedstock.

Second, production, gross receipts and state and local utility taxes are often imposed as a percentage of authorized utility revenues or rates. If the tax is imposed upon the end-user as an excise tax, the compounding of state or local taxes on top of the Btu tax would not occur. Collecting the tax at the city-gate or other points upstream builds the tax increase into the cost of energy where the local jurisdiction imposes a sales or gross receipts tax on utility bills. In some states, these taxes could increase the burden of the tax by up to 15 percent above the payment if the tax was collected at the retail level. The State of New York imposes a gross receipts tax of 5.61 percent, for example, while the City of New York adds a 2.35 percent tax. Illinois imposes gross receipts taxes of five percent and the City of Chicago adds a municipal gross receipts tax of eight percent, while the State of Texas imposes a two percent gross receipts tax on residential users of gas and the City of Houston imposes a four percent tax. The compounding of taxes, primarily severance and gross receipts taxes, and royalty burdens, are major concerns at the production level.

Third, imposing the tax at the end-user level would eliminate the timing problem associated with gas storage and gas imbalances. The Administration's proposal will require owners of natural gas storage facilities to pay taxes on their inventories or "floor stocks." For pipelines, and some utilities, the Btu tax imposed on storage gas would reach some gas which may never be consumed since it is injected into storage in order to maintain the operational integrity of the storage facility. Taxing gas in storage creates a timing problem, where the tax may be paid far in advance of ultimate sale and subsequent collection. Almost one trillion cubic feet of gas goes into storage facilities and may not be consumed for as long as a year.

There is also gas that is needed for line pack to maintain the appropriate amount of pressure and gas flow in the pipeline and for cushion gas in a natural gas storage reservoir. While this gas is never consumed, paying the tax at an upstream point would tax gas that is not used for energy. Also, imposing the tax upstream could include gas that is lost and stolen or unaccounted for gas. Taxing line pack, stored, unaccounted for and lost gas could increase the tax burden on natural gas companies and consumers by as much as 10 percent.

3. Flow Through and Regulatory Lag

Third, the collection point should maximize the possibility of complete flow through of the tax and not disadvantage gas versus competitors in the marketplace. The tax should also minimize the gas company's exposure to a regulatory lag problem.³ Pass through can be approached in either of two ways: (1) applying the tax directly on the ultimate consumer in the form of a natural gas excise tax; or, (2) including the tax in the original cost of the gas commodity. If the tax is an excise

³ Regulatory lag refers to the time between the imposition of the tax and reflection of the tax in customer's billed rates. In most jurisdictions, gas companies would go through a rate or tariff proceeding to include the costs of the tax in customer rates, which could take up to a year or more. During this waiting period, the utility would carry the cost of the tax.

tax collected from the end-user, the seller of gas most likely could avoid incurring the costs of pipeline or utility rate and tariff proceedings. This is because the legal incidence of the tax is at the retail level and the tax is not a part of the utility's cost of service, subjecting the utility to a rate hearing.

If history is any guide, regulators will treat the flow through of taxes differently in each jurisdiction. City-gate collection creates difficulties due to the different points and allocation of transportation gas flowing through it. For some companies, there would be no mechanism to allow a flow through at the city-gate. In many cases, a rate case would have to be filed. Some jurisdictions might not allow full pass through of the costs of the tax and subject utilities to absorbing those costs. Several states commissioners have indicated they are not willing to allow utilities to pass through the tax in consumer rates and the State of California has held hearings on the issue. In other jurisdictions, regulatory lag might become a problem, and a persistent one, given that the tax rate will change each year. If the incidence of the tax is at the pipeline, there would be concerns of regulatory review where the tax is imposed on top of the transportation charge rather than the gas cost.

4. Importation of Natural Gas

The tax should not be imposed to disadvantage domestic natural gas companies in comparison with Canadian natural gas suppliers. U.S. natural gas suppliers compete head to head in key U.S. markets with Canadian natural gas suppliers. An excise tax would eliminate distortions between domestically produced and foreign imported natural gas which otherwise will arise if the points and time of taxation are not the same for both fuels.

5. Preventing Conflicts With Other Government Policies

The Administration has stressed its support of the use of clean-burning fuels, such as natural gas. Imposition of the tax in a manner that impairs the ability of the industry to be a stable and viable industry clearly conflicts with this policy. Collection of the tax is critical to those, such as producers, with long-term fixed price contracts, which serve government policies and consumers by providing long-term gas supplies at stable prices. Suppliers locked into such contracts cannot increase prices to reflect the tax burden. Many low volume stripper wells, which are marginally economic, would feel the pinch if the tax is collected upstream.

Imposing the tax at the retail level avoids the need to preempt state or federal ratemaking treatment of costs related to providing utility service. This approach would eliminate the necessity of statutory language aimed at encouraging regulators to flow through the tax.

IV. PREEMPTION

If a Btu tax is imposed on our industry and at the city-gate, the Council urges Congress to enact legislation that will direct state PUCs to allow utilities to effectively and expeditiously flow through the tax costs to customers in their gas bills. The Administration is considering a normalization type approach for effectuating recovery of energy tax costs. However, the Administration's approach increases the potential damage to gas companies by denying certain tax benefits (i.e., accelerated depreciation of public utility property and investment tax credit reflected in rates over the life of the asset) for periods which the tax is not completely passed through to consumers. An excise tax on the end-user is the best mechanism to ensure the immediate and complete flow through of the tax.

The Council believes the normalization approach is not an effective tool to encourage regulators to flow through the tax. Our preliminary figures indicate that the magnitude of the excise tax would greatly exceed the size of the tax benefits of normalization for gas utilities. We are concerned that regulators may opt for the politically popular short-term action of denying flow through and sacrificing the smaller normalization benefits to avoid the larger gas tax. Utilities could be doubly penalized where they are denied flow through and lose their tax benefits of normalization.

The normalization approach has not been previously applied for compelling the flow through of an energy tax. There is a danger, based on past experience, of disputes arising between utilities, regulators and the Internal Revenue Service (IRS). Given the problems which have already occurred involving the application of the normalization rules, it would be inappropriate to overload this already controversial mechanism with a new mandate—to assure the recovery of an expense. For example, in *City of LA v. CPUC*, 15 C. 3d 680, utilities were penalized nearly \$500 million when the IRS interpreted normalization to require the utilities to reflect tax benefits in a different manner than the state PUC. Similarly, recent disputes between utilities and regulatory commissions regarding normalization and the treatment of consolidated tax return losses expose utilities to enormous penalty risks.

We therefore urge Congress, if a Btu tax at the city-gate is unavoidable, to add provisions in the tax legislation other than normalization that would effectively and immediately enable utilities to completely pass through the costs of the tax to consumers. We will work with you on developing appropriate language for this purpose.

V. DOUBLE TAXATION

If the tax is not collected from the end-user, the Council urges Congress to address the issue of double taxation caused by gross receipts and other state and local taxes by including legislative language that would exclude the Btu tax from any form of federal, state, local or other taxation. Further, the entity remitting the tax to the Treasury should not be liable for any amount of the tax that is in excess of the amount collected from that party on whom the tax is imposed. In that regard, the utility would remit to the pipeline only what it collects from the customer.

VI. METHANOL AND ETHANOL EXEMPTION

The Council strongly opposes the exemption of methanol and ethanol from the tax. We believe such an exemption would substantially distort the market for alternative fuel vehicles and potentially cripple the emerging market for compressed natural gas vehicles.

VII. CONCLUSION

The Council in its March 4 letter to the President urged that the proposed Btu tax upon natural gas be paid by the ultimate consumer and collected by the entity selling that gas to that party. We also stated the four member associations are on record of not supporting energy taxes, but are ready to work with the Administration on the economic package. Likewise, we will work with the Congress in structuring the tax to minimize its burden on our industry and its customers. Imposing the tax at any point other than the end-user will result in significant burdens in collection, administration and flow through of the costs of the tax in consumer rates. It would also thwart the Administration's stated goal of preventing serious economic distortions.

If a Btu tax is to be collected at the city-gate, strong preemption language is needed to minimize the costs of absorption upon utilities. Further, gas utilities should only be required to pay to pipelines what they collect from end-users. To avoid the problem of double taxation, Congress should adopt legislation excluding the Btu tax from any form of federal, state, local or other taxation. Finally, methanol and ethanol should not be exempted from the tax if all alternative transportation fuels are to be treated equally.

PREPARED STATEMENT OF JOHN J. COLLINS

INTRODUCTION AND SUMMARY

My name is John J. Collins. I am senior vice president for government affairs of the American Trucking Associations (ATA), the national trade association of the trucking industry. I appreciate the opportunity to comment on tax proposals for economic stimulus and deficit reduction on behalf of the more than 30,000 companies that belong to ATA or its 51 state affiliates and 10 specialized national affiliates.

The trucking industry employs 7.8 million Americans, accounts for approximately 5% of gross domestic product, and plays a central role in the competitiveness of U.S. industry. Clearly, the industry's health is closely tied to that of the economy as a whole, and we are vitally interested in proposals to improve economic performance in both the short and the long run.

The President has proposed an ambitious package of spending and tax changes. Overall, the spending changes are in the right direction, and we are encouraged that Congress swiftly agreed to a similar amount of spending cuts in adopting the budget resolution. In addition, the President has recently proposed improving the availability of bank credit, a vital form of stimulus for the small businesses that make up the vast majority of the nation's 200,000-plus trucking companies.

As for the President's tax proposals, the trucking industry is prepared to make its share of sacrifices to achieve lasting economic improvement. But we do not believe it is fair to require trucking to make extra sacrifices for goals that are intended to benefit all Americans. Specifically:

- o ATA does not oppose a truly broad-based, level energy tax that taxes all fuels at the same rate, even though that does place a burden on energy-intensive industries. But the Administration's proposed tax would fall more than twice as heavily on transportation as on users of other energy sources, while providing numerous exemptions. As it stands, that plan is neither fair nor balanced and must be adjusted. The President wisely rejected an overt fuel tax; don't enact instead a camouflaged fuel tax that you label an energy tax.
- o Don't index the energy tax. Indexing the tax would add to its unfairness and would be a significant step away from Congressional oversight of rates.
- o We applaud the recent recommendation to move the 2.5-cent-per-gallon general fund fuel tax into the Highway Trust Fund. The full amount should go into the highway account and be spent in accord with the spending rules and levels Congress approved in the Intermodal Surface Transportation Efficiency Act of 1991.
- o Corporate and individual rate increases are an unfortunate step back from the 1986 Tax Reform Act, which the trucking industry supported. Keep existing rates.
- o Don't cut back the business meal deduction for truck drivers, whose on-the-road meals are a modest and fully justified business expense.
- o Don't penalize trucking companies that build or expand facilities by lengthening the writeoff period for terminals and other nonresidential structures.

- o Neither a temporary, incremental investment credit, nor a permanent credit that is available only to certain small businesses, would deliver effective stimulus. Both credits would cost more in terms of complexity and offsetting revenue increases than they are worth. Scrap both credits and use the money to alleviate some of the inequities mentioned above.
- o In contrast, the proposed alternative minimum tax depreciation relief is an evenhanded, low-cost simplification that should be adopted promptly.

BROAD-BASED ENERGY TAX

Our number one concern is the proposed energy tax. We are pleased that the President remained firm against an explicit tax on highway fuels. Although ATA would prefer that energy-intensive industries not be penalized, we would not oppose a truly broad and level energy tax that taxes all fuels at the same rate. However, a tax that hits the only fuel available to heavy trucks at 2.3 times the rate that applies to users of other energy sources, while allowing more than a dozen exemptions, constitutes a camouflaged gas tax. It is not fair or balanced and must be adjusted.

The Administration has proposed to tax natural gas, coal and electricity from nuclear and hydro sources at a rate of 25.7 cents per million BTUs (British thermal units), a measure of heat content. Petroleum would be taxed at 59.9 cents per million BTUs, two and a third times as high a rate as for other fuels. These taxes would begin on July 1, 1994 at one-third of the above rates, rising to two-thirds on July 1, 1995, and the full rate on July 1, 1996. Thereafter, the rates would be adjusted for general inflation as measured by the change in the gross domestic product (GDP) deflator.

The 1996 rates would amount to 7.5 cents per gallon for gasoline and 8.3 cents per gallon for diesel fuel, based on the heat content of each fuel. These rates would be very costly for the trucking industry, which uses roughly 12 billion gallons of gasoline and 24 billion gallons of diesel fuel per year.

BTU tax unfairly burdens trucking

At 1996 tax rates, commercial truck owners would have to pay roughly \$2.9 billion in added fuel costs, or 10% of the gross revenue projected from the tax. This burden is totally unfair, given that trucking accounts for less than 5% of GDP. Put another way, at 1992 profit levels, the tax would equal roughly 50% of the industry's profits.

Truck owners and other highway users have already been paying more than their share for deficit reduction. Since the 1990 budget agreement, 2-1/2 cents per gallon of fuel tax revenue has been diverted into the general fund instead of the Highway Trust Fund. That provision adds \$900 million per year to the fuel bills of commercial truck owners.

There is no justification for placing such an enormous added tax burden on the freight transportation industry, when that industry plays a vital part in enhancing U.S. international competitiveness and the tax is intended to benefit the entire economy.

Administration officials have mentioned but not specified "externalities" or environmental costs associated with petroleum.

But there are already a variety of both explicit and hidden environmental taxes on petroleum and various products. Explicit federal taxes include the Superfund, Leaking Underground Storage Tank, and Oil Spill Liability Trust Fund taxes. Many states have similar taxes, some at even higher rates than the federal taxes. In addition, gasoline users in much of the nation must now pay 5-10 cents more per gallon in winter months for oxygenated fuel. And by October 1993, highway diesel fuel will cost an estimated 4-7 cents per gallon more to cover the cost of reducing the fuel's sulfur content in accordance with Clean Air Act rules.

Adding the Administration's camouflaged 8-cent fuel tax to the clean diesel "tax" means that truck operators will be paying as much as 15 cents a gallon for purposes that do nothing to build highways or transit. These non-highway diesel fuel levies are on top of 20 cents a gallon of federal highway tax and state taxes on diesel fuel that run as high as 33 cents, for example, in New York state. This is an extraordinary set of tax burdens to impose on an industry whose profit margin hovers around 2%.

In short, it would be totally unfair to single out trucking and other transportation industries for a higher rate of BTU tax than other energy users.

RECOMMENDATION: If a broad-based energy tax is adopted, lower the rate on petroleum to the same level as other fuels.

In addition to our dissatisfaction with the unfairness of taxing petroleum more than other fuels, ATA has several technical or design suggestions regarding indexation, visibility, collection point and floor stocks taxes.

Indexation of the BTU tax

The Administration has proposed indexing the BTU tax after 1997. Indexing has never before been used to create unlegislated tax increases. (Income tax indexing, in contrast, is used to assure that inflation alone does not increase individual tax burdens.)

We think it would be unwise for Congress to abandon its oversight of excise tax rates in this case, for several reasons. First, increasing rates would add to discrimination against energy users, shifting an ever larger share of the deficit reduction burden onto these taxpayers.

Second, the wide swings in price indexes add uncertainty about future energy tax rates that would make it difficult for truck buyers and other energy-intensive businesses to plan investments efficiently. Carriers that move freight under contracts that do not allow fuel-cost adjustments (most currently do not) would also be harmed until the contracts come up for renewal. The proposed indexing mechanism, the GDP deflator, has varied from a 10% change in 1981 to a 2.6% change in 1986, and other indexes have varied even more.

Third, the BTU tax would depress Highway Trust Fund receipts, once again undermining the solvency of the highway spending program. The Administration's proposed level of petroleum tax would cost the Highway Trust Fund roughly \$300 million in fiscal 1997 by driving up fuel prices and thus curbing demand. Indexing the BTU tax could lower trust fund receipts even more in future years.

RECOMMENDATION: Do not index the BTU tax.

Visibility

Motor carriers want any energy tax to be as visible as possible. This may make it easier to achieve one of the Administration's goals, that of making energy users more aware of the cost of energy. Separate statement of the tax or other measures to increase its visibility may be useful both for freight that moves under contract and for rates approved by the Interstate Commerce Commission and state regulatory agencies.

Collection point

The Administration has proposed to collect the tax on petroleum products at the point these products leave the refinery (the tailgate). Evasion of gasoline and diesel fuel taxes has been an enormous problem at both federal and state levels. The collection point for the energy tax on petroleum products should be chosen in a manner that minimizes both potential for evasion and the compliance burden on law-abiding taxpayers.

Floor stocks taxes

The Administration would require payment of floor stocks taxes--taxes on the amount of taxable fuels held by a business--on each adjustment date, with a de minimis exemption. To minimize burdens on taxpayers and the IRS, this exemption should be set no lower than \$300. Otherwise, the cost of compliance would exceed the tax due, especially for carriers that store fuel in numerous locations. Furthermore, the IRS should have authority to adjust this de minimis amount upward, for instance to the next 1000 gallons.

GENERAL-FUND FUEL TAX

The Administration's modified package recommends that the 2-1/2-cent general-fund fuel tax (now scheduled to expire in 1995) be continued permanently but be added to the Highway Trust Fund after its current termination date. We strongly support this recommendation and urge that the full 2-1/2 cents go into the highway account and be spent on a timely basis for highway purposes in accordance with the terms Congress approved in the Intermodal Surface Transportation Efficiency Act of 1991. Using the funds for nonhighway purposes, or impounding them to make the deficit look smaller, would again be an unjustified added burden on highway users.

The full amount is needed in order to assure that there is enough money in the highway account after 1995 to keep spending at appropriate levels. Given the long lead time on highway planning and construction, it is essential that the funding be assured today. In fact, fairness and trust fund solvency would be improved still more by shifting the 2-1/2 cents back to the Highway Trust Fund effective immediately, instead of waiting until late 1995.

RECOMMENDATION: Put all proceeds from the 2.5-cent general fund fuel tax into the highway account of the Highway Trust Fund to be spent on a timely basis for appropriate highway purposes.

CORPORATE AND INDIVIDUAL RATES

The trucking industry was an early and vigorous supporter of the 1986 Tax Reform Act. Even though many carriers wound up with higher tax bills, the industry felt that reducing top marginal tax rates for corporations and individuals would be good for the economy and would reduce tax-driven decision-making.

Now the Administration has proposed to increase the top corporate rate to 36%, for companies making more than \$10 million. But the owners (shareholders) of these large companies are more likely to be pensioners and middle-class investors than millionaire "fat cats." Unlike individual tax rates, corporate tax brackets do not correspond to the income or wealth of the individuals who own the companies. A lower maximum corporate rate, applied to all corporate income, would be fairer than a surtax on a minority of larger companies.

The Administration also has proposed raising the top individual rate to nearly 40% (almost 41% for the vast majority of high-income taxpayers, who are also subject to a disguised rate increase through the cutback in itemized deductions). This steep jump from the current 31% top rate is another step back from the 1986 Act and will affect some trucking companies that are taxed as S corporations, partnerships or proprietorships.

RECOMMENDATION: Do not increase corporate or individual rates.

BUSINESS MEAL DEDUCTION

The Administration has proposed to limit the deduction for business meals and entertainment to 50% of cost rather than the current 100%, effective January 1, 1994.

Such a change would be very unfair to medium- and long-haul trucking companies and their drivers (whether employees or independent contractors), who incur a large amount of legitimate and unavoidable business meal expenses. Many drivers must eat all meals away from home 200 or more days per year. These meals are eaten at truck stops and other modest establishments. The meals are clearly ordinary and necessary business expenses and are anything but lavish or frivolous. The drivers either are reimbursed for those meals at the federal per diem rates of \$26 to \$38 per day, or make use of IRS meal allowance rules that permit them to claim these legitimate business expenses. Denying 50% of that modest, unavoidable expense is not fair tax policy.

RECOMMENDATION: Do not cut back the deduction for meals, at least for meals that do not exceed the top federal per diem rate.

LONGER WRITEOFFS FOR STRUCTURES

The Administration has proposed to give limited relief from passive loss rules to real estate professionals. The revenue loss from this change is to be made up by stretching out the depreciation period for structures, including trucking terminals and warehouses, to 36 or 37 years, from 31.5 years currently.

Few trucking companies would benefit from the passive loss relief. Yet any carrier (or other business) that builds, expands or extensively remodels a terminal or other facility would have to recover its depreciation costs more slowly under these changes.

RECOMMENDATION: Do not penalize owners of nonresidential structures by lengthening depreciation periods.

INVESTMENT TAX CREDIT

The Administration has proposed a two-tier ITC. Businesses with gross receipts under \$5 million would be eligible for a permanent credit on all equipment; larger businesses would be

eligible for a temporary credit (through 1994) on purchases that exceed a certain percentage of historical investment. Credit percentages would vary according to the depreciation recovery period assigned to each asset type. A large number of other rules would further limit the amount of credit on each investment.

Our judgment is that neither the permanent small-business ITC nor the temporary incremental ITC would provide any sort- or long-term investment stimulus in the trucking industry.

Many trucking companies invest primarily in tractors (the power units that pull trailers). Other investment dollars go heavily for trucks (power units with attached cargo space) and trailers. Even the maximum credit rates for these asset classes, as shown in the table below, are too low to provide effective stimulus to investment. Further restrictions on companies subject to recapture or basis adjustment, minimum tax, net operating loss, aggregation, startup, passive-loss, at-risk and other rules water down the benefit still more.

MAXIMUM ITC RATE AND TAX SAVINGS FOR TYPICAL TRUCKING ASSETS

| | <u>Small carriers</u> | | <u>Large carriers</u> | |
|--------------------------------|-----------------------|-----------------|-----------------------|-----------------|
| | <u>'93-94</u> | <u>Post-'94</u> | <u>'93-94</u> | <u>Post-'94</u> |
| <u>ITC rate on:</u> | | | | |
| Tractor | 2.33% | 1.67% | 1.17% | 0 |
| Truck or trailer | 4.67% | 3.33% | 2.33% | 0 |
| <u>Maximum tax savings on:</u> | | | | |
| \$50,000 tractor | \$ 770 | \$ 550 | \$ 385 | 0 |
| \$50,000 truck or trailer | 1540 | 1100 | 770 | 0 |

Note: Maximum tax savings equal percentage shown times \$50,000, less 34% basis adjustment or recapture. If Administration's proposed 36% corporate rate is adopted, many large carriers would save even less.

Truck leasing companies are particularly concerned about the incremental credit. Unless appropriate anti-abuse rules are written, their customers would have an incentive to switch from leasing to purchasing equipment so as to get an ITC. The Treasury has acknowledged the need to avoid this tax-driven result, but crafting effective rules may not be easy.

The more restrictions that are imposed to limit abuses or revenue losses, the more money and effort businesses must expend in trying to understand and comply with the rules instead of actually investing. On the other hand, with or without detailed rules, the tax treatment of similarly situated companies is likely to vary.

The case has not been made that an ITC provides very effective short-run stimulus, or that it is a fair way to help business in the long run. And, even though most trucking companies have less than \$5 million in gross receipts, they benefit more from tax changes that help the economy as a whole than from changes targeted only at certain small businesses. Furthermore, the nearly \$30 billion cost of the ITC proposals over fiscal 1994-98 requires unacceptable increases in other taxes as a result.

RECOMMENDATION: Scrap both forms of ITC and use the savings to eliminate the petroleum differential in the BTU tax, the corporate and individual tax rate increases, or the cutback in the business meal deduction. Any of these changes would be fairer and less complex.

AMT DEPRECIATION RELIEF

The Administration has proposed to simplify and slightly liberalize the depreciation calculation for alternative minimum tax (AMT) purposes. We applaud this long-needed step, which will help all businesses in a nondiscriminatory fashion at minimal revenue cost. In fact, the revenue loss should be even less than the Treasury and Joint Committee on Taxation staffs have estimated, given the savings on compliance that both taxpayers and the Internal Revenue Service should realize from eliminating this arduous calculation.

RECOMMENDATION: Adopt AMT depreciation simplification and relief, with the earliest possible effective date.

MACROECONOMIC EFFECTS AND CONCLUSION

The Administration has proposed a complex set of tax and spending cuts and increases, which are intended to achieve a combination of short-term stimulus and higher long-term growth through better-targeted government spending and lower deficits.

These proposals will have mixed effects on trucking. Probably the most important effects are the macroeconomic ones: the impact on growth, employment and inflation. On that score, we would make two observations. First, there is a lot of skepticism in the trucking industry as to whether spending and tax "stimulus" is likely to be needed, effective or desirable. Many trucking executives would prefer to skip both the stimulus and as many of the tax increases as possible and get immediately to deficit reduction, primarily through spending cuts.

Having said that, however, the trucking industry is certainly willing to make its share of sacrifices, if that will contribute to long-run, noninflationary growth. But we believe any sacrifices must be fairly shared. We do not believe we should be singled out to pay more than our share for national goals--be they short-term stimulus, long-term investment or deficit reduction--that are intended to benefit everyone.

PREPARED STATEMENT OF A.W. DAHLBERG

Mr. Chairman and Members of the Committee:

I am A. W. Dahlberg, President and CEO of Georgia Power Company. Georgia Power is the largest subsidiary of The Southern Company, one of the largest investor-owned electric utility holding companies. The Southern Company serves nearly 3.4 million customers in the states of Georgia, Florida, Alabama, and Mississippi. I appreciate the opportunity to appear today representing the Edison Electric Institute (EEI) to express our strong opposition to the Administration's Btu energy tax proposal.

EEI is the association of electric utility companies. Our members serve 99 percent of all customers served by the investor-owned segment of the industry. We generate approximately 78 percent of all electricity in the country and provide electric service to 76 percent of all ultimate electricity customers in the Nation.

EEI strongly supports the policy goals of the President and the Congress to reduce the federal budget deficit and to promote a strong economic recovery. We have consistently supported these

efforts. Difficult decisions will have to be made involving how much and which spending reductions and tax increases, if any, are needed in order to strengthen the economy and reduce the deficit. We believe that deficit reduction should occur principally through spending reductions and, only if a tax increase is necessary, a broad-based consumption tax rather than a Btu energy tax should be enacted.

EEI strongly advocates sound economic, environmental, and energy policies. These policies should be developed so that they are in consonance with one another. Congress enacted new and strengthened environmental and energy statutes in 1990 and 1992. The proposed Btu energy tax must be examined in light of what has already been enacted and the proposal's economic cost. We believe the net effect of the proposed Btu energy tax will result in unsound economic, environmental and energy policy.

Overview of Btu Energy Tax

The Administration has proposed a Btu energy tax which would tax energy at various points in the fuel use chain. The proposal significantly revises our Nation's energy policy by altering the economics of energy through a complex tax on different forms of energy at different levels. The tax artificially alters the relative price of fuels, sometimes taxing at two different rates, and places disparate tax burdens on competing energy and electricity suppliers. The revised Btu energy tax proposal places most of the tax burden on electric and gas utilities, oil refiners, and importers of refined petroleum products, while many other energy producers bear no economic risks associated with the tax and some may receive a competitive advantage due to the tax, some even a windfall. The proposed Btu energy tax would make our Nation's products less competitive in the international market place, impose significant additional burdens on the energy industry at the same time as it is implementing changes to comply with the recently enacted Clean Air Act Amendments of 1990 (CAAA) and the Energy Policy Act of 1992, and cause regional dislocation by disproportionately increasing consumer costs. We urge you to reject the Btu energy tax.

Economic Impact

The U.S. economy is the strongest economy in the world, and worker productivity is higher than in any other nation. The significant growth in the use of electricity (a doubling since 1970) continues to support these goals. At the same time, the overall energy efficiency of the economy has improved substantially. Today, the U.S. uses 25 percent less energy per dollar of GDP than in 1970. Against this background, Btu taxes would have unintended and undesirable economic impacts. The productivity of the nation would decline. This is because the Btu energy tax will reduce economic growth, cause jobs to be lost, and increase inflation. Since a large tax increase would be imposed on a small base (energy expenditures account for only about 8 percent of GDP), its negative impact is greater than many other possible revenue raising choices.

The harmful impact of the Btu energy tax on the Nation's GDP is confirmed by a recent study conducted by the National Association of Manufacturers. This study estimated that the proposed Btu energy tax could reduce GDP by more than one-half percent in 1996, 1997 and 1998 and reduce employment by more than 600,000 jobs, when the

Btu energy tax is fully phased in.¹ Other studies have shown lower job losses, depending upon the effectiveness of monetary policy to accommodate the tax changes; however, all major studies have consistently shown a negative impact on the economy resulting from the proposed Btu energy tax. In our view, while the magnitude of the impact may be in question, the direction is not. A Btu energy tax will harm the economy.

The harmful effects of the Btu tax stem from the inherent inefficiency associated with this type of tax. A recent DRI (Data Resources Incorporated) analysis of the Administration's Btu tax proposal indicates that GDP will decline by \$25 billion in 1997 when the tax is fully phased-in.² This suggests that GDP decreases by more than a dollar for every new dollar of tax revenue. On the other hand, a broad-based sales or consumption tax has a cost to the economy of approximately 26 cents for every dollar of tax revenue.³ Thus, the Btu energy tax is a less efficient tax which will needlessly constrict the economy and reduce the number of American jobs.

International Competitiveness

The importance of international competitiveness to the American economy should not be understated. In 1992, growth in U.S. exports accounted for one-third of the Nation's .1 percent growth in GDP. Without question, the Btu tax will adversely effect U.S. competitiveness as the price of U.S. produced goods and services rises in consonance with higher energy prices. By imposing a tax that foreign competitors escape, relative U.S. costs rise and our competitiveness declines and GDP will decline. This will harm our balance of payments in two ways. First, imports into the United States will compete more effectively against domestic producers. Second, foreign competitors will be in a stronger position to capture the export customers of U.S. producers. In short, U.S. costs go up, foreign competitors' costs do not. Ironically, the effect of the proposed Btu energy tax is to serve as a subsidy for foreign imports since these goods will be exempt from this tax.

Some have argued that, because U.S. energy costs are relatively low in comparison to other countries, our economy could withstand imposition of this tax. Although several of our largest trading partners in Europe and the Pacific Rim have higher gasoline taxes, they have generally rejected other unilateral broad-based energy taxes as too harmful to their domestic economies and international competitiveness⁴. We cannot afford to lose our competitive position.

¹ National Association of Manufacturers (February 24, 1993). Testimony of Jerry J. Jasinowski, President, National Association of Manufacturers, On the Comparative Merits of the Administration's Energy Tax Proposal and a Broad-Based National Consumption Tax, Before the Committee on Energy and Natural Resources, United States Senate. (Washington, DC), p.15.

² DRI/McGraw-Hill (March 25, 1993). Data Resources Summary Table for the U.S. Economy - Administration's Btu Tax Alone Without Federal Reserve Accommodation. (Washington, DC).

³ Jorgenson, Dale W. and Kun-Young Yun. (November 1990). The Excess Burden of Taxation in the United States. HIER Discussion Paper No. 1528. Harvard University. (Cambridge, MA), pp. 504-505.

⁴ IEA Coal Research (August 1990). Market Mechanisms for Pollution Control: Impacts for the Coal Industry. (Washington, DC).

Customer Effects

The burden of the Btu energy tax will fall unevenly across income classes, industries and regions of the economy. It is estimated that 27 percent of the additional revenue raised by the Administration's total tax package will fall on energy consumers⁵. EEI has estimated the percentage cost increases on electricity for each of our customer classes resulting from the proposed Btu energy tax. The Btu energy tax will cause the average price of electricity for our customer groups to increase as follows:

| | <u>Overall</u> | <u>Residential</u> | <u>Commercial</u> | <u>Industrial</u> |
|-------------------------------|----------------|--------------------|-------------------|-------------------|
| Percent Increase ⁶ | 4.5% | 3.7% | 4.0% | 6.2% |

A tax on an essential service such as electricity would be especially regressive for residential consumers as it is not based on the ability to pay. The proposed Btu energy tax is a major tax increase on low and moderate-income households and senior citizens. These households spend a greater proportion of their income on energy needs and generally are hard-pressed to pay for additional measures to conserve energy. A recent study by the Environmental Protection Agency found that consumers in the bottom 20 percent of incomes spend 7.5 percent of their incomes on energy consumption versus those consumers in the top 20 percent of incomes, who spend only 4.7 percent.⁷ This tax will fall on the elderly and others on fixed-incomes at a time when lower investment earnings and skyrocketing health care costs already are decreasing their standards of living. This is the worst type of regressive tax in that it is placed directly on essential services such as home heating, cooking and lighting.

We applaud the Administration's desire to counter the regressiveness of the proposed Btu energy tax. However, we believe that the measures proposed by the Administration such as increased funding for LIHEAP (Low Income Home Energy Assistance Program), the Earned Income Tax Credit, food stamps and weatherization programs will not counter, for many taxpayers, the regressive nature of the proposed Btu energy tax because of eligibility, participation, and funding difficulties. As an example, LIHEAP serves less than 25% of eligible households.

Our industrial customers, of all customer classes, bear the greatest percentage increase in their cost of energy from the proposed Btu energy tax. In some regions of the Nation, the increase in the cost of electricity will exceed 10 percent for industrial consumers.⁸ With such price increases, there will be regional and industry dislocations along with associated job losses. Basic industries, such as steel, aluminum, chemical, paper, agriculture, airlines, cement, fertilizer manufacturing, glass, and plastics which consume large amounts of energy will be significantly and adversely affected by energy taxes. Farmers also

⁵ Administration's Revenue Proposals.

⁶ Edison Electric Institute (1993). EEI Summary of President Clinton's Btu Energy Tax Proposal. (Washington, DC).

⁷ The Distributional Impacts of a Carbon Tax. U.S. Environmental Protection Agency, Energy Policy Branch. (May 27, 1992). Washington DC, p.8.

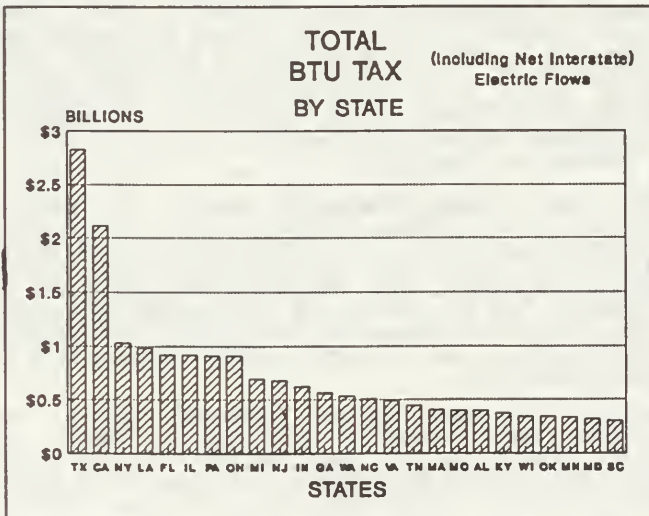
⁸ Edison Electric Institute (1993). Company Estimate of Btu Energy Tax. (Washington, DC).

will be affected. At a time when industries need to concentrate resources on productivity improvements and developing new markets and products, resources would be diverted to pay for a Btu energy tax.

In addition, included in the Administration's Btu energy tax proposal is a provision that calls for Btu energy tax rates to be indexed to inflation after 1997. This indexing provision would cause an inflationary spiral with Btu energy taxes contributing to higher inflation and higher inflation contributing to even higher Btu energy tax rates.

Regional Disparities

As mentioned earlier, a Btu energy tax will result in regional disparities, and its impact will vary across different states. For instance, those utilities which burn significant amounts of residual oil will bear a larger tax burden due to the supplemental energy security tax. The floor stocks tax and the indexation component of the tax will also cause regional disparities. The chart below shows some geographic disparities of the Btu tax.



Source: State Energy Data Report 1960-1990. Table 4, p.21

Utilities which maintain a large inventory of coal and, even more so oil, will pay a larger floor stocks tax than those utilities which rely on other fuels. Our preliminary estimate of the industry's floor stocks tax payments is \$1.1 billion over the three-year phase-in period of the tax. Because different utilities rely on different fuels, the floor stocks tax will accelerate and increase the tax payments of electric utilities in certain regions of the country.

On a state and local level, many jurisdictions across the country impose piggyback taxes on utilities such as taxes on gross receipts or on the sales price. Because some utilities are subject to higher state and local taxes than other utilities, the piggyback tax effect exacerbates regional distortions. For example, piggyback taxes vary from zero to more than 15% throughout the country.

Environmental and Energy Policy

The Administration has said that the main goals of the Btu energy tax are to promote energy conservation, encourage energy efficiency, reduce pollution and reduce the deficit. However, the costs of an energy tax are unlikely to lead to any meaningful environmental benefits. The imposition of energy taxes increases the likelihood that production activities which are negatively affected will seek locations elsewhere in the world where environmental regulations are less stringent. Thus, if this occurs, global emissions may actually rise.

Substantial environmental improvements are already being achieved and will continue to be achieved under existing U.S. laws and regulations without the necessity of a Btu energy tax. Between 1970 and 1989, air pollution declined significantly: particulates fell 61%, sulfur dioxide 26%, carbon monoxide 40% and volatile organic compounds 31%.⁹ In 1972, the Nation spent about \$17 billion on pollution abatement and control.¹⁰ By 1990, these expenditures had risen to \$90 billion according to the U.S. Department of Commerce.¹¹

Electricity is already substantially "taxed" because of the costs to achieve this compliance with environmental regulation. For instance, electric utilities spend billions of dollars each year to comply with numerous environmental statutes. The CAAA alone are expected to add \$3 to \$4 billion to consumer electric bills annually.¹²

Both the CAAA and the recently passed Energy Policy Act of 1992 included significant provisions to encourage conservation and to protect the environment. The CAAA, when fully implemented, are estimated to cost the U.S. economy at least \$21 billion annually.¹³ It makes sense to allow these statutes to be fully implemented and to review their benefits to the environment before placing increased costs on the energy sector of the economy.

The Energy Policy Act of 1992 sets out an energy policy designed to meet future energy requirements for the Nation. Among other provisions, this legislation encourages increased emphasis on conservation and alternative energy resources. Energy efficiency programs in existence before this legislation represented a significant dedication of resources on the part of electric utilities toward conservation goals. For example, over \$2 billion was spent by the industry for energy efficiency programs in 1992.¹⁴ Our industry currently has over 2,000 energy efficiency programs in place.¹⁵ The programs already in existence and those yet to be

⁹ Council of Economic Advisors (January 1983). Economic Report of the President. (Washington, DC), p. 231.

¹⁰ Bureau of Economic Analysis, U.S. Department of Commerce. Survey of Current Business. (Washington, DC), p.35.

¹¹ Ibid., p.36.

¹² Office of Air and Radiation, Environmental Protection Agency (November 15, 1992). Implementing the 1990 Clean Air Act: The First Two Years. (Washington, DC), p.39.

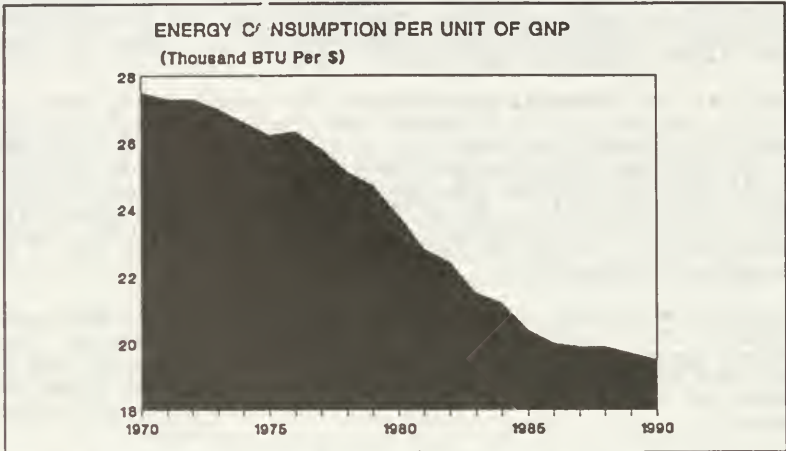
¹³ Ibid, p.17.

¹⁴ Barakat & Chamberlin, Inc., and EPRI (December 1992). Impact of the Electric Utility Sponsored DSM Programs on Future Customer Electricity Demand. EPRI Research Project 2863-8. 3rd Ed., (Palo Alto, California), p.ES-17.

¹⁵ Plexis Research, Inc. for EPRI. (January 1993) SURIS: DSM Survey Information System. (Donegal, PA), p.1.

developed in accordance with the Energy Policy Act will be far more constructive than a Btu energy tax in achieving energy efficiency goals.

It is important to emphasize that America consumed substantially less energy per unit of GNP in 1990 than it has over the prior twenty years as is highlighted by the chart below. One reason



Source: Arthur Andersen/Cambridge Energy Research Associates. Table 2, p.57.

for expected gains in energy efficiency along with continued growth in the use of electric power is that electricity is a more efficient and environmentally sensitive energy source in many applications where it is replacing direct fuel combustion at the point of end use. Electricity, as a percent of total energy consumption, has grown from 15 percent in 1950 to 37 percent in 1990.¹⁶

For example, electricity also is being used in high-tech applications that lack alternative power sources, e.g. computers and automation. Examples of the use of electrotechnologies that are more efficient than technologies using other fuels include: electric arc furnaces, induction heating, microwave drying, plasma-fired technology, and freeze concentration in the chemical, food, glass, paper, timber and petroleum industries. The future is one in which the combination of improving energy efficiency and greater electrification will continue.

The electric utility industry has supported efforts to establish sound energy policies, e.g., the policy of domestic self-reliance. As a result, the industry's fuel mix has changed since the 1970s, when the oil embargo caused the industry to reduce its reliance on oil in the production of electricity. During 1991, approximately 55 percent of the electricity produced by the industry was generated from coal, 22 percent from nuclear, 10 percent from hydro, 9 percent from natural gas, 4 percent from oil which is down from 16 percent in the 1970s, and less than one percent from other

¹⁶Energy Information Administration (1991. Annual Energy Review 1991. (Washington, DC), p. 15.

sources, such as solar, wind, wood, waste and geothermal.¹⁷ The New York Times singled out the electric utility industry as responding positively to the energy crisis of the 1970s.¹⁸ As a Nation, we should be encouraging the use of electricity for environmental, energy and economic policy reasons, not discouraging it with the proposed Btu energy tax.

Implementation Concerns

Other reasons why this tax is unwise and should be rejected include the numerous implementation problems. These problems, as more fully explained below, involve price signals for efficiency, the ability to recover the tax, the loss of tax benefits if recovery is not granted, additional costs due to state and local piggyback taxes, competitive issues, and potential price distortions, some of which create winners and losers due to existing contracts. Some of these examples demonstrate the problems of trying to "fix" the tax by simply addressing the problems of implementation.

The Administration has indicated that it believes that an energy tax will be effective in achieving energy conservation. To achieve this effect, the Administration, through Secretary Bentsen, has stated that the tax must be imposed on ultimate customers. As presently proposed, the tax would be imposed on the utility and/or fuel suppliers, and therefore the tax does not achieve the Administration's stated goal. For electric utilities, this means the tax should be imposed at the retail level. This is the level at which decisions are made on electricity usage and energy efficiency measures. Because of this decision-making, it is most important that the ultimate product-user achieve the price signal from the increased taxes. This signal could very well be muted by rate recovery difficulties which are discussed in the next paragraph.

Since the Administration's proposal puts the liability for and payment of the tax on the utility, with the exception of petroleum products and natural gas purchased from a local distribution company, there is no clear and easy process for recovering the cost. The various regulatory jurisdictions have unique formulas for ratemaking and cost recovery. Some companies have fuel adjustment clauses (FAC). These FACs may or may not be broad enough to recover fuel-related taxes. Further, because the point of collection in the Administration's proposal resides at different points in the production, transportation, purchase and generation cycle for different fuels, some elements of the tax may be recoverable through FACs while others will not.

If there is no existing procedure such as a FAC to recover the tax, the mechanism to recover this tax will be a general rate case or a single-issue rate case. Most jurisdictions will not entertain single-issue rate increases; general rate cases are very time- and resource-intensive, requiring significant administrative costs to be incurred by utilities, regulatory agencies and interveners.

Any Btu tax proposal should not penalize utilities with the loss of other tax benefits in cases where regulators don't permit recovery of the tax or where it is not possible to do so. Such a requirement may not work because of rate moratoria or for other valid business reasons that preclude an increase in electric rates

¹⁷ Edison Electric Institute (1992). Statistical Yearbook of the Electric Utility Industry/1991. (Washington, DC), p.29.

¹⁸ The New York Times. (August 25, 1992). Oil? Nation's Utilities Are Not So Worried. (New York).

to recover the tax. This proposal, in effect, subjects utilities to "double jeopardy." In such a situation, not only will a utility be unable to recover some or all of the cost of the tax as envisioned by the Administration, but it will have to pay a further penalty by being denied other tax benefits -- so far undefined -- thus further increasing the utility's costs and decreasing its cash flow, and in turn customers' costs.

As mentioned previously in our discussion of regional disparities, another problem is the so-called "piggyback" effect of state and local taxes. The current tax burden on electric utilities and their customers, including federal, state and local taxes, is among the highest of any industry. As an example, the electric utility industry currently bears an average state and local tax burden that is more than twice that imposed on all other business sectors.¹⁹ One of the largest components of a utility customer's bill is for taxes. In many states, 20 percent or more of a customer's electric bill is for taxes either charged directly to the customer or indirectly through taxes paid by electric utilities. This does not include the taxes built into the price of products and services which utilities buy.

The proposed Btu energy tax will have a compounding effect when additional taxes, i.e., gross receipts, franchise fees, sales taxes and other utility taxes are automatically increased due to an energy tax imposed on electric utilities. The increase in these "piggyback" taxes is significant and adds to the customers' cost. These piggyback tax costs are a direct result of the way the proposed Btu tax is imposed. Because the Btu energy tax is imposed upon the utility and/or its fuel costs, these piggyback taxes will automatically increase. If the Btu energy tax were imposed at the retail level, which is consistent with the energy conservation and environmental goals of the Administration, these additional piggyback tax costs generally would be avoided resulting in lower costs for utility customers.

Also, the differing Btu tax rates applied to fuel sources and the point in the supply chain at which the tax is imposed will affect competition among various fuels. Certain fuel supply contracts may be indexed to the price of other fuels subject to differing tax rates under the proposed Btu energy tax. Unless the tax is on the ultimate consumer, unanticipated distortions of current relationships among energy sources and double taxation are inevitable. For example, under the Administration's revised Btu energy tax proposal, oil is taxed at the refinery tailgate. Because certain natural gas supply contracts are indexed to the price of oil, the cost of the gas will increase due to the tax on the oil, and the utility which purchases the gas from the pipeline also will have to pay the tax on the gas itself. This results in a situation wherein the gas supplier earns a windfall profit, possibly \$0.599/MMBTU and utility customers are charged \$0.856/MMBTU due to the energy tax. These factors, if not taken into account, could have an adverse and unanticipated impact on energy competition and increase customers' costs.

In attempting to solve these implementation problems, it has been suggested that this Btu tax be imposed at the retail level, i.e., in the form of an excise tax. This would address the problem of recoverability; avoid the piggyback effect, thus reducing costs to consumers; and avoid potential price distortions. It, of course, would not avoid the fundamental economic concerns with the tax which we have outlined.

¹⁹ Edison Electric Institute. (1993) Analysis of the Electric Utility Industry 1991 Tax Burden. (Washington, DC).

Competitive Issues

The Administration's modified Btu energy tax contains a number of provisions that directly affect the competitive balance within the electricity industry. Independent Power Producers (IPPs) with fixed price contracts entered into before the date of enactment basically escape having to pay an energy tax. Instead, a special tax is imposed upon the purchasing utility equal to the tax that would have been paid by the IPP had the exemption not existed. The Administration's objective in moving the tax further downstream in the direction of the ultimate customer is to ensure that IPP's are not subjected to the tax on its fuel purchases without any opportunity for recovery.

We have several concerns about this proposal. First, there is no statutory definition of an IPP: Qualifying Facilities (QF) under PURPA are apparently included, but the Treasury's statement is not explicit in this regard. Also, it is not clear whether the small number of entities which are not QFs, but "non-traditional" utilities regulated by FERC, are included as IPPs.

Next, the term "fixed price contract" is not defined. Contracts for purchase of QF capacity and/or energy are quite varied; there is no clear way to classify them into discrete "fixed price" and "variable price" groups. In a single contract, some price elements may be fixed, while others are variable.

There is a great variety of contractual terms and conditions in power purchase agreements between QFs and utilities. An EEI survey disclosed that some QF suppliers could, under their current contracts, pass the Btu tax through to their utility customers. Out of 54 responding utilities with QF suppliers, 9 answered "yes," 31 answered "no," and 14 answered "varies." While a majority said "no," a significant number said "yes," and uncertainty surrounded many other responses.

In addition, the rates which many utilities pay QFs include variable energy charges. As the cost of fossil fuel to the utility increases or decreases, the utility's "avoided costs" change, and so do the rates paid to the QF for power purchased by utilities. Of 133 respondents to an EEI survey *State Regulation of Non-Utility Generation*, 63 have rates of this sort. Thus, the QFs in question will receive a major windfall if payments to them go up because of the effect of the tax on fuel and/or utility avoided costs. This windfall translates into higher costs for consumers. EEI has been collecting estimates from affected utilities on the amount their payments will increase. Estimates received so far are as high as \$20,000,000 per utility annually.

Since "fixed price" is not defined, and since a rate with a variable energy charge may contain a fixed capacity charge, it is possible that a QF may receive, under the Administration's proposal, both the windfall and the right to (in essence) pass the tax through. Others may exercise contractual rights to pass the tax through, and still receive the windfall. In such instances, the utility's customers will end up paying the tax twice.

Fuel purchased by a cogenerating QF is used in several processes, including the production of electricity. Often, the generation of electricity is a by-product. The fuel purchased must be allocated among the various processes for purposes of calculating the tax credit.

If IPPs, including QFs, with fixed price contracts are not taxed, then equity requires similar treatment for utilities with fixed price contracts that sell electricity to other utilities in the

wholesale market. Many such contracts restrict rate changes, and the Supreme Court has held that FERC usually cannot disregard such restrictions.²⁰ Allowing an exemption for IPPs, but not for traditional utilities under the same circumstances, is not equitable and upsets the competitive balance within the electric industry. In essence, it says that IPPs can be allowed to circumvent their contracts, utilities cannot.

Also, with regard to imported electricity, under the Administration's modified Btu tax, fuel supply contracts for gas and electricity with prices linked to average fossil fuel costs can result in higher payments to foreign suppliers, creating an unintended windfall for them as fossil fuel prices in the U.S. increase because of the tax.

Summary

In summary, EEI strongly opposes the proposed Btu energy tax because it will be counterproductive in reducing the federal budget deficit and promoting a strong economic recovery. If, after spending reductions are made, additional revenues are needed, then Congress should consider a broad-based consumption tax. Since a broad-based consumption tax is an option being considered for the financing of health care reform, it appears logical to consider all types of taxes at the same time. Energy expenditures account for only about 8 percent of the GDP. A Btu energy tax, which by definition is narrowly based, is simply an inequitable way for the government to raise tax revenue by focusing only on energy and U.S. produced goods and services.

A broad-based consumption tax could be spread uniformly across the U.S. economy and would not unduly penalize particular businesses or regions of the country. A Btu tax is more harmful to the economy than a broad-based consumption tax. Unlike a Btu energy tax, a broad-based consumption tax will not harm our international competitiveness because it could be "border-adjustable" and, as such, could be removed from U.S. exports and imposed upon foreign imports. A broad-based consumption tax may also exempt essential goods and services and thereby may not be as regressive as a Btu energy tax. A broad-based consumption tax also could encourage savings and investment, since the incidence of the tax is on the ultimate consumer of all domestically-consumed goods and services.

The proposed Btu energy tax is unwise economic, environmental and energy policy. It would seriously damage the economic recovery, and it will hurt U.S. international competitiveness. In addition, the Btu energy tax alters our Nation's energy policy and would result in questionable environmental benefits. If Congress determines that the proposed tax should be enacted, the tax should be structured in a way to address the problems with implementation that I have discussed. This would minimize the piggyback tax effects on our customers, minimize competitive distortions among fuels and generators of electricity, and maximize the opportunity to achieve the Administration's stated energy conservation and environmental goals while keeping customer costs lower.

EEI appreciates the opportunity to present its views. We are ready to assist this Committee and the Administration in their deliberations on this matter.

²⁰FPC v. Sierra-Pacific Power Company, 350 U.S. 348 (1956).

PREPARED STATEMENT OF ROGER C. DOWER

Thank you, Mr. Chairman, for this opportunity to testify. My name is Roger Dower. I am Director of Climate, Energy and Pollution Program at the World Resources Institute, a non-profit environmental policy research center here in Washington.

The purpose of my testimony this morning is to construct a general context within which the Administration's energy tax proposal should be considered. It is far too easy to lose sight of the potential environmental and economic benefits of a broad-based energy tax as we move into narrow debates on who and what to exempt.

I am sure that it is not necessary to remind this committee that the present U.S. tax system is extraordinarily burdensome—impeding the ability of this country to achieve increased productivity and growth. If raising revenues is going to part of a credible deficit reduction package, then it is critically important that we select taxes that impose as little penalty as possible on the economy—even better if you can find taxes that actually provide a net plus. Our traditional sources of revenues—payroll taxes, income taxes and taxes on capital—hardly fit the bill. These penalize precisely those activities that are essential to economic progress: work, savings, investment, and entrepreneurship. The after-tax returns to work and savings efforts are considerably reduced by taxes. As a result, people tend to work, save, and invest less than they would have done otherwise. Over time, the resulting lag in the acquisition of skills, capital, and technology greatly reduces income and productivity growth.¹

Many efforts have been made to estimate the size of the excess burden of taxes in the U.S. Even after the tax reforms of 1986, it has been estimated that the average excess burden of the tax system was 18 cents for each dollar collected.² Applying this estimate to 1990 federal tax revenues of about \$1.1 trillion, the cost to the economy in terms of reduced economic resources could be in the range of \$200 billion per year. Including state revenues of \$800 billion from income, payroll, and excise taxes raises the level of potential economic costs to around \$340 billion per year.³

The numbers cited above are based on average tax rates across all federal (and state) revenues. But marginal tax rates are substantially higher than effective average rates. Thus, the efficiency costs of each new dollar raised by taxing economic "goods" are much higher than the average burden across all dollars raised. Various estimates of the marginal excess burden of taxes on labor earnings range from 30 to 48 cents for each dollar of additional tax revenue. The estimated marginal excess burden of individual income taxes, which fall partly on savings, is even higher, from 40 to 60 cents on the dollar.⁴

A broad-based energy tax, properly designed, offers a very different kind of alternative. Rather than distorting economic decisions, it corrects the market place as well as raise revenues. The best case for a broad-based energy tax rests on very different grounds than more traditional sources of revenues.

A BROAD-BASED ENERGY TAX

Energy use is not an economic end in itself. There is no good economic reason to encourage energy use through low energy prices. The graphs appended to this testimony, taken from a WRI study published several years ago,⁵ illustrate the fact that having low energy prices is not associated with faster rates of economic growth. This is true for OECD countries and developing countries, energy exporting countries and energy importers. Having low energy prices is not associated with having low rates

¹ As a technical matter, this kind of economic loss is referred to as excess burden and is a measure of the true welfare cost of taxation. A useful review of the theory and estimation of efficiency losses from taxation can be found in: Ballard, C.L., "Marginal Efficiency Cost Calculations for Different Types of Government Expenditures: A Review," 1991.

² This is based on estimates provided in Jorgenson, Dale W. and Kun-Young Yun, "The Excess Burden of Taxation in the U.S." HIER Discussion Paper No. 1528 (Cambridge: Harvard University, November 1990) which calculated an average efficiency cost of the entire tax system to be 18 percent.

³ The federal and state revenue estimates for 1990 were derived from U.S. Government, *Economic Report of the President with the Annual Report of the Council of Economic Advisers* (Washington, DC: U.S. Government Printing Office, February 1991), Tables B1 and B2.

⁴ These estimates are drawn from the following sources: Edgar Browning, "On the Marginal Welfare cost of Taxation," *American Economic Review*, March, 1987; Charles Ballard, "Marginal Efficiency Cost Calculations for Different Types of Govt. Expenditure: A Review," paper presented at the Australian conference in Applied General Equilibrium Analysis, Melbourne, Australia, May, 1991; Dale Jorgenson and Hun-Young Yun, "The Excess Burden of Taxation in the United States," Harvard Institute for Economic Research, Cambridge, Mass. November, 1990.

⁵ Mark Kosmo, *Money to Burn?*, World Resources Institute, Washington, D.C., October, 1987.

of inflation, with having a favorable balance of trade, or with attaining any other economic objective. There is simply no connection.

What having low energy prices is associated with quite strongly is having low rates of energy efficiency and low rates of improvement in energy efficiency. The last two graphs show this very clearly. This was true in the 1980s, and I would hazard that it remains true in the 1990s.

If there is no particular virtue in using lots of energy, is there any harm? Well, for one thing, the U.S. is a net energy importer, and net energy imports accounted for more than two-thirds of our overall trade deficit. Moreover, the U.S. is a sufficiently large importer that our demand has some marginal impact on world oil prices, in the sense that moderating our demand would help keep those prices stable.

Further, as Dan Yergin's recent book *The Prize* ably pointed out, control of world energy supplies has been a source of international armed conflict throughout this century. Conflicts in the Persian Gulf continue this tradition, exposing this country to risks of military involvement, disruption of supplies, or both. These are externals cost associated with energy use, not captured in the prices paid by energy consumers. People argue about their magnitudes, but nobody suggests they are trivial.

ENVIRONMENTAL EFFECTS

The other main category of external costs associated with energy use is environmental. Throughout the fuel cycle, there are significant environmental damages. At the extraction stage, there are problems with land disturbance, mine drainage and wastes, oil spills, ecological disruptions from hydroelectric storage, and so on. At the conversion stage, there are impacts on water, land, and air quality. Atmospheric emissions in the U.S. still total 20 million tons of SO_2 , 19 million tons of NO_x , 62 million tons of CO, 17 million tons of VO_x , and 7.5 million tons of particulates. The large majority of these emissions emanate from energy use in transportation, electricity generation, and industrial processes.

Many of these impacts are addressed by environmental regulations, with varying degrees of effectiveness. Nonetheless, it is clear that there are still significant environmental damages associated with energy conversion and use that are not captured by market prices. Focussing just on electricity for a moment, I have included in my testimony a table from a recent EPA report.⁶ This table summarizes a number of recent estimates of the environmental damages from electricity generation at current standards of pollution control, expressed in terms of cents per kwh. The ranges of the estimates are quite wide, and I put no emphasis on the particular numbers, but point out that even the low end of the ranges—for coal-fired plants, for example—suggests that externalities due to air quality impacts alone add approximately ten percent to generating costs. Although more and more public utility regulatory commissions throughout the nation are experimenting with "adders" to conventional cost calculations to reflect these environmental externalities, it remains true that such damages are not adequately reflected in market prices.

In addition, perhaps the principal environmental externality associated with fossil fuel combustion is the threat of climate change from accumulation of CO_2 and other greenhouse gases. In its most recent assessment of the science of global warming, the Intergovernmental Panel on Climate Change (including scientists from all over the world) repeated its earlier finding that "emissions resulting from human activities are substantially increasing the atmospheric concentrations of the greenhouse gases . . ." and that "The evidence from modelling studies, from observations and sensitivity analyses indicate that the response of global mean surface temperature to doubling CO_2 is unlikely to lie outside the range of 1.5 to 4.5 degrees centigrade."⁷ There is still great uncertainty about the risks such a shift in climate would entail, but they are widening: coastal flooding, disruption of hydrological patterns, regional drought, species extinction, ecological disturbances, and others. These potential costs are not reflected in current energy prices or regulations. Thus, energy prices are now distorted because they do not reflect the full costs of energy conversion and use.

A tax that moves energy prices toward full costs is not a distortionary tax; it is a corrective tax, and improves the allocative efficiency of the economy. Energy users tend to use energy excessively because the prices they face are less than the full incremental costs. If set correctly, an energy tax should yield net economic gains,

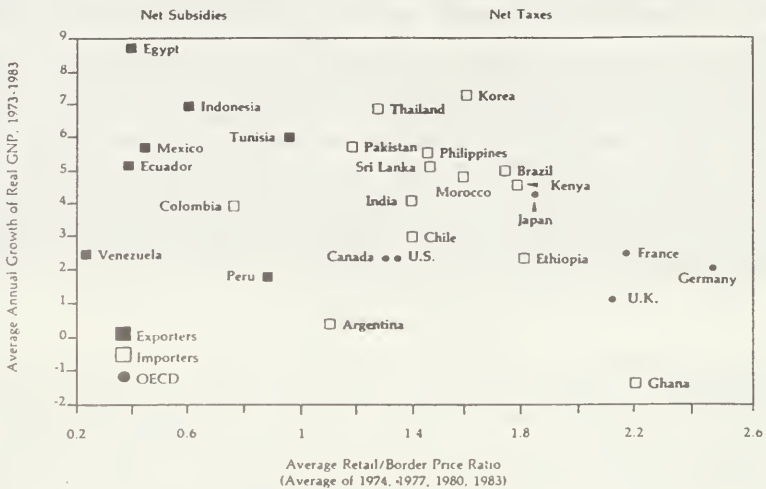
⁶U.S. EPA, Air and Radiation Division, *Renewable Energy Generation: An Assessment of Air Pollution Prevention Potential*, Wash. D.C., March, 1992.

⁷Intergovernmental Panel on Climate Change, 1992 *IPCC Supplement*, Working Group 1, Scientific Assessment of Climate Change, World Meteorological Organization and U.N Environment Program, 1992.

not economic losses. This insight is absent from standard macroeconomic modelling because such models are not constructed to recognize external costs. Rather, such costs are assumed away, although they are far from negligible in reality. Because the proposed tax rates are relatively low and are phased in gradually, it is unlikely that the proposed tax overshoots the level that would correct for various external costs.

The United States has ratified the Framework Convention on Climate Change, adopting the goal of stabilizing CO₂ emissions at 1990 levels by the end of the century. One of the most cost-effective ways in which to reach that goal is through a broad-based increase in the price of fossil fuels. This would provide market signals throughout the economy to all direct and indirect energy users, preserving the maximum flexibility for innovation and market substitution. Of course, to address the climate problem as the sole objective, the preferred instrument would be a carbon tax, levied on fuels in proportion to their carbon content per BTU. A carbon tax would fall relatively more heavily on coal than the modified BTU tax proposed by the Clinton administration. But both are likely to have similar effects on CO₂ emissions at least over the next decade.

Figure 6. Real Growth Rates of Gross National Product and Retail/Border Price Ratios, Annual Averages, 1973 to 1983**

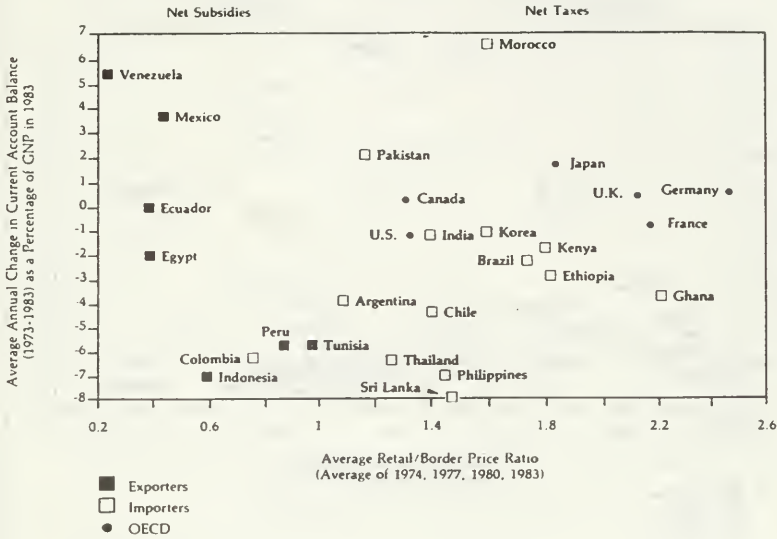


** Retail prices are a weighted average (by consumption shares) of the prices of the four primary petroleum products—gasoline, diesel oil, kerosene, and heavy fuel oil. Ideally, these retail prices would take into account the consumption of natural gas, electricity, and coal since in a few countries (e.g., coal in India and Korea) these fuels account for substantial shares of consumption. However, data limitations make this impossible. In any event, changes in petroleum prices are the best proxy for changes in retail energy prices—for the 22 OECD countries, from 1978-1984, the correlation coefficient between domestic petroleum prices and domestic energy prices is .89. In the developing countries, the correlation is likely to be higher since they are relatively more dependent on oil for commercial energy needs.

| Fitted Regression Line | 95% Confidence Interval for Slope of Line | Correlation Coefficient (x,y) |
|--|--|-------------------------------|
| $y = 5.82 - 1.01x$ [Exporters] (3.95) | -10.67, 8.60 | -0.11 |
| $y = 6.87 - 1.91x$ [Importers] (1.82) | -5.84, 2.02 | -0.29 |
| $y = 3.14 - 0.38x$ [OECD] (1.08) | -3.17, 2.41 | -0.17 |
| y = Average Annual GNP Change | | |
| x = Average Retail/Border Price | | |
| * = Statistically Significant at 5% Confidence Level | | |
| Numbers in Parentheses are Standard Errors | | |

Source: World Resources Institute Calculations

Figure 7. Percentage Changes in Current Account Balance and Retail/Border Price Ratios, Annual Averages, 1973 to 1983



Fitted Regression Line

95% Confidence Interval
for Slope of Line

Correlation Coefficient (x,y)

$$y = 6.10 - 14.10x \text{ [Exporters]} \\ (4.81)$$

-25.85, -2.33

-0.80*

$$y = -5.10 + 2.06x \text{ [Importers]} \\ (3.03)$$

-4.49, 8.61

0.19

$$y = -0.93 + 0.52x \text{ [OECD]} \\ (1.06)$$

-2.20, 3.25

0.24

y = Average Annual Current Account Change (1973-1983)

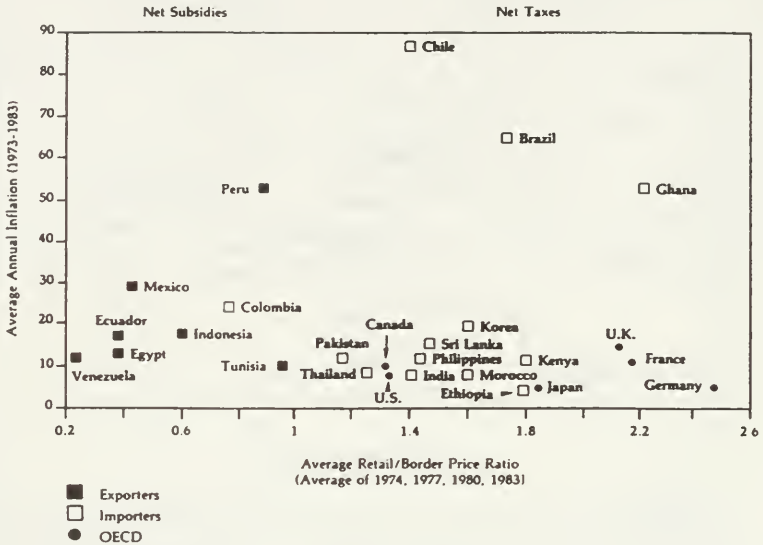
x = Average Retail/Border Price

* = Statistically Significant at 5% Confidence Level

Numbers in Parentheses are Standard Errors

Source: World Resources Institute Calculations

Figure 8. Inflation Rates and Retail/Border Price Ratios, Annual Averages, 1973 to 1983

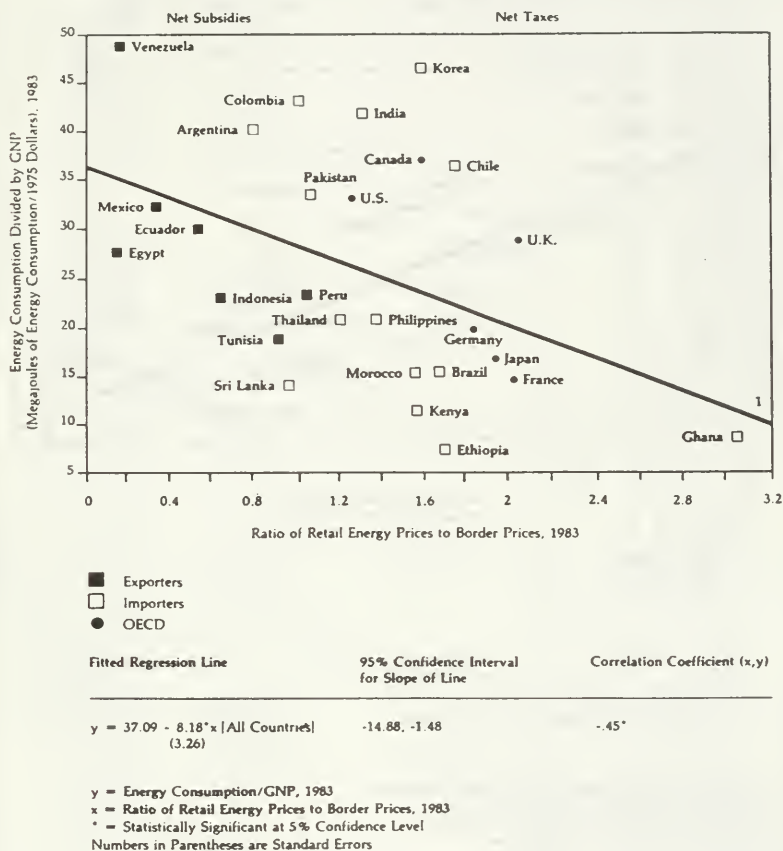


| Fitted Regression Line | 95% Confidence Interval for Slope of Line | Correlation Coefficient (x,y) |
|---|--|-------------------------------|
| $y = 9.96 + 20.80x$ [Exporters] (22.48) | -34.21, 75.81 | 0.38 |
| $y = 65.39 - 20.58x$ [Importers] (36.32) | 109.02, 57.86 | -0.16 |
| $y = 8.89 - 0.21x$ [OECD] (4.03) | -10.58, 10.16 | -.025 |

y = Average Annual Inflation (1973-1983)
 x = Average Retail/Border Price Ratio
 * = Statistically Significant at 5% Confidence Level
 Numbers in Parentheses are Standard Errors

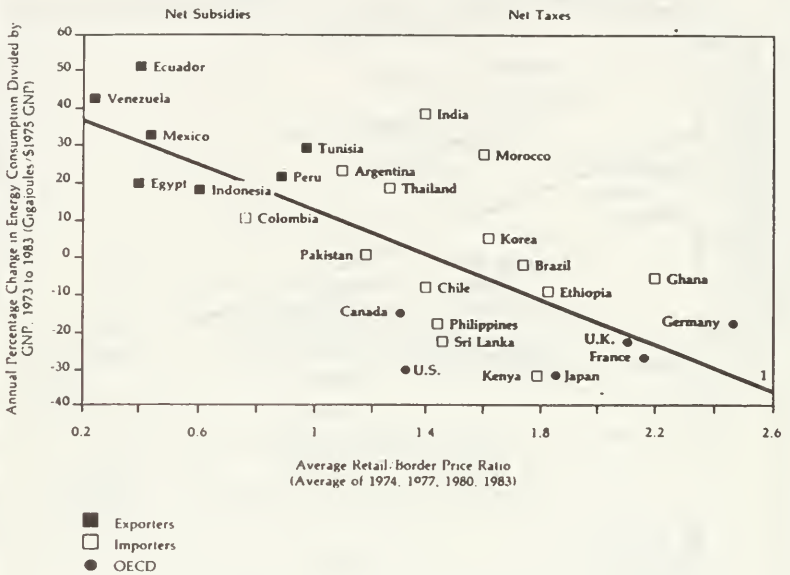
Source: World Resources Institute Calculations

Figure 10. Commercial Energy Efficiency and Energy Prices, 1983



Source: World Resources Institute Calculations

Figure 11. Changes in Commercial Energy Efficiency and Retail/Border Price Ratios, Annual Averages, 1973 to 1983



Fitted Regression Line

95% Confidence Interval
for Slope of Line

Correlation Coefficient (x,y)

$$\hat{y} = 43.11 - 29.93x \text{ [All Countries]} \\ (5.57)$$

-41.39, -18.46

-0.73*

y = Change in Energy Consumption/GNP Ratio (1973-1983)

x = Petroleum Retail/Border Price Ratio (average)

* = Statistically Significant at 5% Confidence Level

Numbers in Parentheses are Standard Errors

Source World Resources Institute Calculations

TABLE I

EXTERNALITY ESTIMATES BY SOURCE AND GENERATION TECHNOLOGY (\$1990 cents/kWh)

| | Low - High | Hohmeyer (a) | Pace (b) | BPA (c) | Tellus (d) | JBS (e) |
|---------------------------|--------------|--------------|-----------|--------------|------------|-----------|
| FOSSIL AND NUCLEAR | | | | | | |
| Combustion Turbine: Gas | 0.1 - 6.0 | 0.6 - 2.9 | 0.7 - 1.0 | 0.1 | 6.0 | 1.6 - 4.1 |
| Combustion Turbine: Oil | 0.3 - 10.3 | 0.6 - 2.9 | 2.6 - 6.9 | 0.3 | 10.3 | X |
| Coal | 0.8 - 10.0 | 0.6 - 2.9 | 2.6 - 5.9 | 0.7 - 1.1 | 4.5 - 10.0 | 2.8 - 8.2 |
| Nuclear | 0.0* - 5.7 | 0.6 - 5.7 | 3.0 | 0.0* | X | X |
| RENEWABLES | | | | | | |
| Photovoltaic | 0 - 0.4 | 0 - 0.2 | 0 - 0.4 | X | X | X |
| Wind | 0 - 0.1 | 0 - 0.0* | 0 - 0.1 | X | X | X |
| Biomass | (0.0*) - 0.7 | X | 0 - 0.7 | (0.0*) - 0.6 | X | X |
| Geothermal | 0 - 0.0* | X | X | 0 - 0.0* | X | X |
| MSW | (3.7) - 48.2 | X | 2.9 | (3.7) - 48.2 | X | X |

* Numbers followed by an asterisk denote values less than one tenth of a cent
Numbers enclosed in parentheses denote a negative cost, or societal benefit

Sources: (a) Olav Hohmeyer, "The Social Costs of Energy Consumption" (Estimates reflect an average for all fossil technologies)
(b) Richard Ottinger, "Environmental Costs of Energy," Pace University
(c) Bonneville Power Administration: 1) "Estimating Environmental Costs and Benefits for Five Generating Resources,"
2) "Generic Coal Study: Quantification and Valuation of Environmental Impacts," 3) "Environmental Cost & Benefits
Case Study: Nuclear Power Plant-Quantification & Economic Valuation of Selected Environmental Impacts/Effects,"
(d) Tellus Institute, "Full Cost Economic Dispatch: Recognizing Environmental Externalities in Electric Utility
System Operation,"
(e) JBS Energy, Inc., "Valuing Reductions in Air Emissions and Incorporation into Electric Resource Planning:
Theoretical and Qualitative Aspects."

PREPARED STATEMENT OF WILLIAM K. DRUMMOND

I am William K. Drummond, Manager of the Public Power Council (PPC). PPC is a trade association representing consumer-owned utilities -- rural electric cooperatives, public utility districts, and municipal utilities -- in the Pacific Northwest. Because of the inherent inflationary and regressive nature of energy taxes, PPC has long opposed the adoption of any form of energy tax. We applaud the Administration for taking significant steps to mitigate these negative impacts and for exempting from taxation energy conservation and nonconventional fuels. Nonetheless, PPC continues to oppose the energy tax in its current form due to the excessive tax burden that would be placed on consumers of hydroelectric energy.

PPC believes that the Administration's proposed energy tax applies a scientifically invalid heat rate to hydropower that results in excessive taxation of this energy source. Correction of this portion of the energy tax would not violate "regional equity," nor significantly reduce the revenue generated by this tax. Furthermore, failure to assign the scientifically correct Btu value to hydropower will result in severe regional economic dislocation and discourage the use of an important renewable resource.

Hydropower is Central to Regional Power Supply and Economy

In order to appreciate the concerns of the Public Power Council with respect to the hydropower portion of the energy tax, it is necessary to understand the role of hydropower in meeting the region's energy needs and fueling the region's economy.

All of PPC's 115 member utilities meet a portion of their total bulk power supply needs through power purchases from the Bonneville Power Administration (Bonneville), and Bonneville serves the entire bulk power needs of approximately 85 of these utilities. Private power companies and certain large industrial consumers also receive large blocks of power from Bonneville. The power that Bonneville markets is almost exclusively generated at the federal multipurpose water projects of the Columbia River system. For those regional utilities that are partial requirements customers of Bonneville, utility owned hydro projects meet a large share of the remaining power needs. Consequently, through federal and non-federal projects, hydropower represents approximately 65 percent of the total electric generation of the region.

Much of the economy of the Northwest is based on the presence of reasonably priced and reliable electric supplies. Aluminum plants, pulp and paper mills, chemical companies, air processing facilities, and other energy-intensive industries have located in the Pacific Northwest, at least in part, because of affordable electric rates. As discussed further below, the price of electricity from the Bonneville Power Administration is escalating at a rapid pace. Soon, many of the energy-intensive industries in the region may be forced to close or relocate in Canada or overseas.

The region has been a show case for conservation, fish mitigation and enhancement, and multiple use of an interstate waterway. However, without competitive electric rates, much of this success will be placed in jeopardy. As additional costs are imposed on the region's ratepayers, large industries will downsize, shut-down, or relocate, households will witness an ever increasing portion of their income dedicated to energy costs, and the ability of the region to finance these important programs will dwindle.

While some inside and outside the region have criticized the region's dependence on hydropower -- or its good fortune in securing once seemingly endless supplies of low-cost electricity -- few can discount the importance of cost-competitive hydropower to the economic vitality of the region.

Hydropower Taxed at Artificially High Rate

As the members of the Committee are aware, the Administration's energy tax is purported to tax each fuel based on its heat content as expressed in British Thermal Units (Btus). However, **under the tax plan, hydropower is taxed at nearly three times its actual Btu equivalency.**

A kilowatt hour of electricity has a heat value of 3,413 Btus. This is an undisputed, internationally recognized standard. Because hydropower projects operate, on average, at 90 percent efficiency (e.g., only 10 percent of the energy potential of falling water is lost in generating electricity), the Btu value of one kilowatt hour of hydropower is approximately 3,754 Btus. However, under the Administration's proposal, the tax on hydropower is based on the Btu input of an average fossil fuel plant -- 10,315 Btus per kilowatt hour -- rather than the actual Btu equivalent of a kilowatt hour of electricity generated by falling water.

This scientifically inaccurate and unjustifiable Btu value incorrectly assumes that hydropower is as inefficient as fossil fuel fired generation and results in nearly a tripling of the tax rate applied to hydropower. This excessive tax ignores the high efficiency of hydropower and discourages the use of this important renewable energy source.

Energy Tax Could Cripple Northwest Economy

While the Pacific Northwest is historically characterized as having low electric rates, these rates are steadily rising. The pending Bonneville Power Administration rate case is likely to result in at least a 15 percent rate increase. Resource acquisitions, Endangered Species Act compliance, and sustained drought are likely to result in additional rate increases of 20 percent over the next two years. The Administration's PMA repayment initiative, if adopted, will add a 4 percent rate increase. If unadjusted, the energy tax will add an additional 12 percent increase to current BPA rates. Combined, the region could face a 50 percent increase in the cost of power within three years.

As previously mentioned, the economy of the Northwest is particularly energy intensive. Many large industrial consumers depend on low-cost energy supplies to remain competitive in international markets. For instance, the cost of electricity represents approximately one-third the cost of producing aluminum. According to the Direct Services Industries, an association of large Northwest energy consumers, aluminum plants in the Northwest pay average electric rates that are 20 percent higher than their world competitors. That differential will increase with adoption of the pending rate case and would increase further under the energy tax.

Aluminum plants are not the only energy-intensive industries in the Northwest. Energy costs are 25 to 35 percent of the cost of electrolytic chemicals produced in the region and 7-20 percent of the cost of pulp and paper.

While the Administration's energy tax is clearly designed to generate revenue for deficit reduction, this is not an end in itself. Rather, it is a means of achieving the goal of long-term economic growth and fiscal health. **If the overarching purpose of the plan is the restoration and maintenance of a strong economy, then it must be recognized that economic conditions in the Pacific Northwest are extremely fragile and unlikely to sustain the impact of the proposed energy tax as currently calculated.** Some examples of the weakness of the Northwest economy include:

- the world price of aluminum, due to dumping by the former Soviet Union, is very low with little sign of improving. Aluminum companies directly employ 10,000 workers;
- Boeing has recently laid off 27,000 workers;
- the recovery of the endangered spotted owl has cost thousands of jobs in the timber industry; and
- most major businesses are reducing their workforce and freezing salaries.

The current and future health of the region's economy is at stake. Access to cost-effective energy supplies is the region's economic lifeline.

Reducing the tax rate for hydropower to the scientifically correct energy rate of 3,754 Btus would provide much needed economic relief to the Northwest without dramatically decreasing the total revenue generated by the energy tax. According to our calculations, the reduction in tax receipts would be approximately \$500 million per year once the tax is fully phased in.

Because of the severe economic consequences of the resulting rate increase on Northwest businesses and industries, failure to adjust the tax on hydropower will likely result in a greater increase in the national deficit due to the likelihood of industry labor reductions, shut-downs and relocations.

Hydropower Tax Causes Regional Inequity

Administration officials concede that the imputed Btu value for hydropower is not scientifically justified. They suggest that the higher tax rate was necessary to create equity in the impact of the energy tax on different regions of the country. While this goal is understandable, in fact, **the excessive hydropower tax appears to impose a disproportionate burden on the Pacific Northwest.**

According to a preliminary analysis based on Department of Energy data, the Pacific Northwest is disproportionately impacted by the proposed energy tax:

- Montana has the sixth highest burden with a per capita tax impact 30 percent higher than the national average;
- Washington comes in 12 with a per capita tax impact 20 percent above the national average;
- Idaho ranks 19, with a per capita tax impact 5 percent above the national average; and
- Oregon ranks 23, with a tax impact at the national average.

According to an analysis by the Washington State Energy Office, **if the average tax burden on residents in the region would be 20 percent above the national average. If the Btu conversion rate for hydropower were correctly calculated, residents in the region would pay only two dollars less than the national average,** and residents in some states would continue to pay above the national average.

Some will point to the lower electric rates in the Northwest and question how the tax on hydropower can be reduced without violating regional equity. It must be understood that the higher than average tax burden in the region results primarily from the petroleum surcharge due to long driving distances. According to the analysis of DOE data, the tax on oil will comprise 52 - 64 percent of the total energy tax burden

within the states in the region. The higher than average tax impact in the region also reflects the more severe climate conditions (resulting in higher energy consumption for space conditioning), and the presence of numerous energy intensive industries.

Correcting the Btu conversion rate for hydropower will not create a "windfall" for the Northwest. Nor will this correction violate regional equity.

Value of Hydropower Should be Recognized

Finally, it is important to recognize that the proposed energy tax is the first effort of the Administration to fashion an energy policy. The previously stated objectives of the Administration's energy policy are the encouragement of energy conservation, renewable resources, and environmentally sensitive fuel choices and the discouragement of foreign energy dependence. Given these objectives, use of existing hydropower projects should be advanced, not hindered. Hydropower:

- displaces foreign energy supplies;
- is an important renewable resource, representing 85 percent of our domestic renewable electric generating capacity;
- has less severe environmental impacts than traditional fossil-fired generation. While dams have impacted fish and wildlife and riverine habitat, to date Bonneville ratepayers have paid more than \$1 billion to mitigate these impacts and will continue to pay at least \$300 million per year -- for the foreseeable future -- on additional fish and wildlife expenditures; and
- its low-cost attributes, combined with enlightened utility planning, have enabled the region to pioneer the nation's most aggressive energy conservation program.

Accuracy, Equity, and Economy Justify Tax Rate Correction

PPC urges Congress to tax hydro power at its actual energy value of 3,754 Btus. Making this adjustment will ensure scientific consistency, regional equity, and economic vitality.

PREPARED STATEMENT OF PAUL R. FRY

Mr. Chairman, Members of the Committee, I am Paul R. Fry, Deputy Executive Director of the American Public Power Association (APPA). APPA is a national service organization representing more than 1,750 municipal and other local, publicly owned electric utility systems. These utilities serve fifteen percent of the nation's electric consumers -- approximately thirty-five million Americans.¹ Public power systems are owned by, and are accountable to, the people they serve. APPA's member utilities are located in forty-nine of the fifty states, only Hawaii is excepted.

I. SUSPENSION OF CATEGORICAL OPPOSITION TO ENERGY TAXES

We appreciate this opportunity to present our views on the Administration's economic stimulus, public investment and deficit reduction proposals. I would like to comment specifically on the proposed energy tax and then briefly address some of the other provisions of particular interest to public power systems.

¹ See attached charts for details of U.S. electric utility industry structure by ownership type, generating capacity by fuel type, and fuel used for electric generation by state and region. Also attached are estimated rate impacts of proposed Btu tax for selected public power systems.

APPA has a history of opposition to energy taxes. This opposition has been based on concerns about the inequitable regional distribution of the burden of such taxes, the difficulty of ensuring fair and efficient administration, potential adverse effects on international competitiveness and the fact that an energy tax is inherently regressive.

Despite this history, there is a broad consensus of our membership that the federal budget deficit is a serious issue which must be addressed. The proposed Btu tax is part of a proposal to deal with this issue. Accordingly, our organization has suspended its policy of categorical opposition to energy taxes, and has determined to work with others to perfect the Administration proposal so that it is best formed to achieve its goals in a fair and efficient manner.

In general, APPA believes that any energy tax should treat different fuels, regions, customer classes and electric industry sectors equitably, and should be structured with an eye to fair and efficient administration. Additionally, tax revenues should be used for the purpose of deficit reduction and the tax should contain a sunset provision. Since energy taxes are regressive, steps should be taken to mitigate this effect.

II. CONCERNS WITH PROPOSED BTU TAX

Since its original release, the Administration has issued a number of clarifications and modifications of its proposal. Several of these clarifications and changes respond directly to questions and criticisms APPA offered in its initial response. Examples include:

- a) Exemption of hydroelectricity from pumped storage projects;
- b) Treatment of fuel used in coal gasification plants as an exempt feedstock;
- c) Addition of tire-derived fuels, methane from landfills and other biomass fuels to the list of unconventional fuels which are exempt from the tax;
- d) Clarification of the tax rate applicable to imported electricity; and
- e) Reemphasis of support for collateral measures intend to mitigate the regressive nature of the tax, such as increased funding for the low income home energy assistance program (LIHEAP) and weatherization assistance for low-income households.

While we welcome and support these actions, there remain a number of other features of the proposal which cause us concern.

A. Importance of Deficit Reduction

APPA members believe strongly that Btu tax revenues should be applied to the goal of deficit reduction. This shared goal is the paramount reason APPA has suspended its traditional opposition an energy tax. If the Administration's economic program is successful, it could mean lower long-run costs for all consumers. For example, Treasury Secretary Bentsen has argued that for every tenth of a percentage point that long-term bond yields decline, companies and individuals save ten billion dollars on interest payments. It is essential, however, that energy tax revenues be applied to deficit reduction. We would oppose the "earmarking" of any portion of the Btu tax revenues for any other purpose.

B. Desirability of Sunset Provision

Furthermore, our members believe that the tax should not be perpetual. Rather, it should have a "sunset" feature that cancels the Btu tax automatically and coincidentally with the end of the Administration's economic package. This feature would trigger a mandatory review of the merits of the tax and its contributions to the goal of deficit reduction.

C. Floor Stock Tax

We are concerned about the impact of the floor stock tax. This proposal would apply the Btu tax to utility coal inventories as of the date of initiation of the tax. There are circumstances which require some utilities to maintain very large coal piles, as much as nine months' supply in some cases. For example, in Michigan, some coal-fired electric generating plants rely upon water transport of coal. Because of the seasonal icing of the Great Lakes, coal piles must be built up to guard against the consequent interruption of coal deliveries. Should the floor stocks tax be calculated when such inventories are at their peak, the tax liability could be significant.

We are concerned about the cash flow burden that may be caused by the collection of a retroactive tax on such large inventories. Since inventories have yet to generate revenue for their owners, collection of the tax on unusually large stockpiles should be spread over time so as not to impose an unreasonable burden on cash flow.

D. Design and Administration of Tax

APPA's position with respect to the collection points for the tax is driven by concern for fair and efficient administration. If collecting the tax upstream, nearer the point of production, means fewer taxpayers and, consequently, less costly, surer administration, then that is the structure we prefer.

We understand that the Administration intends that the full burden of the Btu tax be borne by the end users of energy. While others have advocated that full pass through of the tax to ultimate consumers be mandated or coercively "encouraged", this is not our position.

We suggest merely that pass through of the tax be neither prohibited nor limited in any way, including the right to itemize the tax on customer bills. Similarly, the allocation of the tax among a utility's customer classes should remain within the sole discretion of the utility or appropriate regulatory body.

We endorse the Administration's position that there be no exemptions from the tax based on the character of the purchaser. This makes it clear that federal facilities will be responsible for their fair share of the tax as applied to their electricity bills.

E. Fairness

On the important issue of fairness, we believe more information is needed. There is a willingness to accept shared sacrifice in order to deal with the problem of deficit reduction, but the sacrifice must be distributed equitably. Our membership would like to see a detailed, verifiable analysis of who will bear the burden of the proposed tax. Such information is essential for the evaluation of perceived inequities and the modifications proposed for their remedy. We do not believe that the information released to-date is adequate for this purpose.

III. PROVISIONS AFFECTING FEDERAL POWER MARKETING ADMINISTRATIONS

Hydro power is our nation's most abundant renewable resource, accounting for approximately 12 percent of our total installed electric generating capacity. It will continue to make a significant contribution to our energy mix. Federal policy should encourage its use, both development of additional hydro power facilities and relicensing of existing facilities.

APPA reaffirms its support for cost-based rates for electricity marketed by the federal power marketing administrations (PMAs) and its opposition to changes in the repayment practices of the PMAs. APPA opposes the provisions of the Administration's economic package that would reduce net outlays for the PMAs by \$100 million annually beginning in FY 1996 and that would authorize "market incentives" for energy conservation by PMA customers. Federal power customers will share in paying the Btu tax on power marketed by the PMAs; it is unfair to levy additional costs on these systems. The energy conservation market incentive program is fraught with workability problems and violates the principle that federal power should be distributed at cost-based rates.

The proposal levies a surcharge per acre-foot on water sales by Reclamation projects. However, irrigators are required to repay their capital costs of these Reclamation projects only to the extent of their financial ability; those capital costs beyond the ability of irrigators to repay ultimately are repaid by power customers. Any surcharge legislation and subsequent implementing regulations must specify that this water surcharge shall not increase power customers' repayment obligations.

Any Btu tax that is levied on PMA electricity production should be charged proportionally to all beneficiaries of federal power. Thus, the tax should be applied to PMA power distributed to federal agencies and to project power utilized for irrigation features of Reclamation projects. Again, care must be taken in drafting the legislation and implementing regulations to insure that none of these costs are ultimately transferred to the repayment obligation of power customers due to irrigators' limited ability to pay.

IV. OTHER PROVISIONS OF CONCERN TO PUBLIC POWER

The Administration's proposal must be accompanied by other provisions that will promote economic development, protect consumers from the regressive nature of the Btu tax, and encourage various energy efficiency technologies. They include:

- The elimination of the \$15 million private-use restriction placed solely on public power (Section 141 (b)(4) of Title 26 of the Internal Revenue Code). The Tax Reform Act of 1986 lowered the private use test applicable to tax exempt bonds from 25% to 10%. Additionally, a separate limit was imposed on public power. Section 141(b)(4) of the tax code provides that the private use test for public power "output" facilities is to be the lesser of 10% or \$15 million. Exceeding this amount of private use destroys the tax exemption of the bonds issued for such facilities.

No hearings were held on this special restrictive rule for public power. No abusive practices were identified as justification for imposition of this separate limit. No revenue estimate was made to determine whether it would result in a net saving to the Treasury. In short, there was no policy foundation for the enactment of this restriction in 1986, nor was there a financial justification.

This provision restricts public power's flexibility in developing, operating and using bond-financed facilities. In some cases it causes less than optimum use of generating facilities because of the extremely small amount of surplus power that can be sold to nonexempt entities (typically, investor owned utilities and rural electric cooperatives) without jeopardizing the tax exempt status of the bonds.

This gratuitous restriction should be eliminated. It is in the public interest and will contribute to more and sounder infrastructure investments by encouraging valuable public-private cooperation that is in no way abusive of the privilege of tax-exempt financing;

- The inclusion of tax-exempt bond simplification provisions contained in H.R. 13, the Tax Simplification Act of 1993, introduced recently by Chairman Rostenkowski, along with additional tax-exempt bond simplification provisions passed twice last year in H.R. 4210, the Tax Fairness and Economic Growth Act of 1992 and H.R. 11 the Revenue Act of 1992, but vetoed by President Bush. (This would include provisions to increase from \$10 million to \$25 million the bank interest deduction small-issuer exception, and further simplify arbitrage rebate requirements); and
- Full funding for Section 1212 of the Energy Policy Act of 1992 (Public Law 102-486), which provides for an incentive payment program for qualifying renewable energy facilities developed by consumer-owned utilities. Funding of this provision is consistent with the purpose of the exemption of renewables from the Btu tax and is necessary to achieve parity with the tax credit provided to investor-owned utilities.

In addition, deficit reduction and increased public and private sector efficiencies can be advanced by efforts designed to make the government more efficient. The Administration must concentrate on cost-cutting efforts, as well as reducing regulatory lag and taking steps to ensure better coordination and cooperation between federal agencies.

Lastly, APPA supports a number of energy and consumer assistance programs already contained in the Administration's economic package, including in particular the following: energy conservation and efficiency projects, particularly those supporting research, demonstration and commercialization of electric vehicles; joint ventures in support of research, demonstration and commercialization of renewable energy and energy efficiency; magnetic levitation and high-speed rail transportation; accelerating the development of a nationwide broadband, interactive telecommunications network; reducing the backlog of critical operation and maintenance items at Corps of Engineers and Bureau of Reclamation projects; and providing additional job training and retraining.

Number of State and Local Publicly Owned Electric Utilities, By State, 1991

Figures include operating joint action agencies

| | | | |
|----------------------|-----|----------------------|--------------|
| Alabama | 37 | Nebraska | 159 |
| Alaska | 39 | Nevada | 8 |
| American Samoa | 1 | New Hampshire | 5 |
| Arizona | 25 | New Jersey | 9 |
| Arkansas | 15 | New Mexico | 7 |
| California | 46 | New York | 50 |
| Colorado | 32 | North Carolina | 75 |
| Connecticut | 7 | North Dakota | 11 |
| Delaware | 9 | Ohio | 85 |
| Florida | 35 | Oklahoma | 65 |
| Georgia | 53 | Oregon | 17 |
| Guam | 1 | Pennsylvania | 34 |
| Idaho | 11 | Puerto Rico | 1 |
| Illinois | 42 | Rhode Island | 1 |
| Indiana | 73 | South Carolina | 23 |
| Iowa | 138 | South Dakota | 36 |
| Kansas | 123 | Tennessee | 63 |
| Kentucky | 29 | Texas | 80 |
| Louisiana | 23 | Utah | 43 |
| Maine | 5 | Vermont | 16 |
| Maryland | 5 | Virgin Islands | 1 |
| Massachusetts | 42 | Virginia | 16 |
| Michigan | 43 | Washington | 43 |
| Minnesota | 129 | West Virginia | 2 |
| Mississippi | 24 | Wisconsin | 83 |
| Missouri | 91 | Wyoming | 14 |
| Montana | 1 | Total | 2,026 |

U.S. Electric Utility Statistics

Statistics for publicly owned systems, private systems, cooperative systems and federal systems are based on Energy Information Administration Forms EIA-860 and EIA-861. Some adjustments have been made by APPA.

| Number of Utilities | 1991 |
|--------------------------|--------------|
| Publicly owned systems* | 2,014 |
| Private power companies | 264 |
| Cooperative systems | 947 |
| Federal power agencies** | 10 |
| TOTAL | 3,235 |

*Reflects only those utilities which file Form EIA-861 with the Energy Information Administration.

**Includes Alaska Power Administration, Bonneville Power Administration, Southeastern Power Administration, Southwestern Power Administration, Western Area Power Administration, Tennessee Valley Authority, U.S. Army Corps of Engineers, Bureau of Reclamation, Bureau of Indian Affairs and International Boundary and Water Commission. For additional information on federal systems, see page 153.

| Number of Ultimate customers | 1991 | Percent |
|------------------------------|--------------------|---------------|
| Publicly owned systems | 16,565,893 | 14.6% |
| Private | 84,973,561 | 75.0% |
| Cooperatives | 11,706,776 | 10.4% |
| Federal | 29,700 | 0.0% |
| TOTAL | 113,275,930 | 100.0% |

| Kilowatt-Hour Sales To Ultimate Customers (in millions of kWh) | 1991 | Percent |
|--|------------------|---------------|
| Publicly owned systems | 408,385 | 14.7% |
| Private | 2,110,528 | 76.0% |
| Cooperatives | 204,921 | 7.4% |
| Federal | 52,944 | 1.9% |
| TOTAL | 2,776,778 | 100.0% |

| Electric Revenues from Sales to Ultimate Customers (in thousands of dollars) | 1991 | Percent |
|--|--------------------|---------------|
| Publicly owned systems | 24,503,583 | 13.1% |
| Private | 147,582,567 | 78.6% |
| Cooperatives | 14,139,825 | 7.5% |
| Federal | 1,479,079 | 0.8% |
| TOTAL | 187,705,054 | 100.0% |

| Installed Capacity (in thousands of kilowatts) | 1991 | Percent |
|--|----------------|---------------|
| Publicly owned systems | 88,234 | 11.9% |
| Private | 551,564 | 74.6% |
| Cooperatives | 32,880 | 4.5% |
| Federal | 66,573 | 9.0% |
| TOTAL | 739,251 | 100.0% |

Note: Installed capacity includes adjustments for joint ownership. Data reflect utilities that file Form EIA-860, plus Puerto Rico Electric Power Authority.

Data reflect capacity at start of calendar year.

| Kilowatt-Hour Generation (in millions of kWh) | 1991 | Percent |
|---|------------------|---------------|
| Publicly owned systems | 320,017 | 11.2% |
| Private | 2,121,827 | 74.4% |
| Cooperatives | 156,405 | 5.5% |
| Federal | 253,829 | 8.9% |
| TOTAL | 2,852,078 | 100.0% |

U.S. Electric Utility Generating Capacity, 1991

NAMEPLATE CAPACITY IN KILOWATTS. NUMBERS REFLECT JOINT OWNERSHIP AND INCLUDE PUERTO RICO.

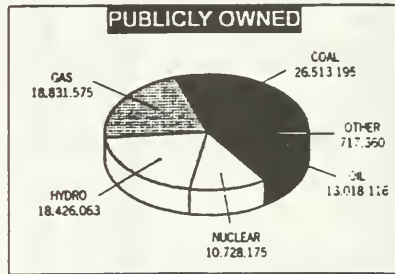
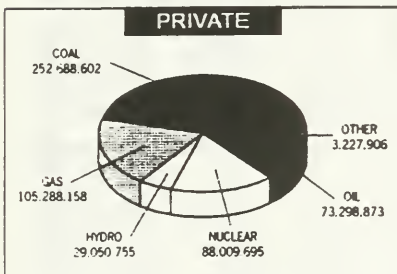
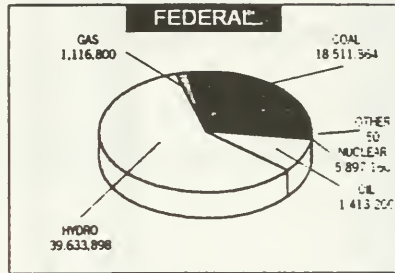
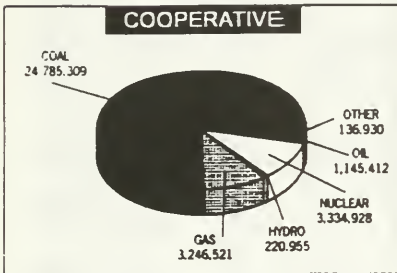
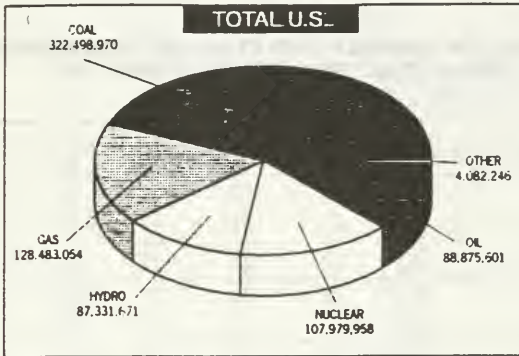


TABLE 24
SOURCES OF ENERGY FOR ELECTRIC GENERATION
TOTAL ELECTRIC UTILITY INDUSTRY

BY STATE AND ENERGY SOURCE
 YEAR 1991p — PERCENT

| State/Division | Total Generation | Coal | Fuel Oil | Gas | Nuclear Fuel | Hydro | Other** |
|----------------------------------|------------------|--------------|-------------|-------------|--------------|-------------|------------|
| Total United States | 100.0% | 54.9% | 3.9% | 9.4% | 21.7% | 9.8% | 0.4 |
| Maine | 100.0 | — | 13.3 | — | 65.8 | 20.8 | — |
| New Hampshire | 100.0 | 24.9 | 12.3 | (*) | 53.4 | 9.3 | — |
| Vermont | 100.0 | — | 0.1 | 1.6 | 78.1 | 17.9 | 2.1 |
| Massachusetts | 100.0 | 33.1 | 43.6 | 10.3 | 12.3 | 0.6 | — |
| Rhode Island | 100.0 | — | 31.6 | 68.4 | — | — | — |
| Connecticut | 100.0 | 9.0 | 33.5 | 2.0 | 52.0 | 1.7 | 1.9 |
| New England | 100.0 | 16.7 | 30.3 | 5.0 | 38.9 | 5.4 | 0.6 |
| New York | 100.0 | 19.8 | 22.0 | 15.9 | 22.6 | 19.8 | — |
| New Jersey | 100.0 | 14.1 | 4.9 | 14.4 | 67.0 | (0.4) | — |
| Pennsylvania | 100.0 | 61.6 | 2.3 | 0.1 | 35.4 | 0.4 | — |
| Middle Atlantic | 100.0 | 40.1 | 10.2 | 7.8 | 34.0 | 7.8 | — |
| Ohio | 100.0 | 88.0 | 0.3 | 0.2 | 11.2 | 0.1 | 0.2 |
| Indiana | 100.0 | 98.3 | 0.4 | 0.9 | — | 0.4 | — |
| Illinois | 100.0 | 42.2 | 0.7 | 0.6 | 56.2 | — | — |
| Michigan | 100.0 | 68.9 | 0.6 | 1.1 | 28.6 | 0.9 | — |
| Wisconsin | 100.0 | 71.0 | 0.1 | 0.4 | 23.3 | 4.8 | 0.3 |
| East North Central | 100.0 | 73.1 | 0.4 | 0.7 | 24.9 | 0.7 | 0.1 |
| Minnesota | 100.0 | 63.4 | 1.5 | 1.1 | 31.0 | 2.0 | 1.0 |
| Iowa | 100.0 | 82.8 | 0.1 | 0.8 | 13.3 | 2.8 | 0.1 |
| Missouri | 100.0 | 79.7 | 0.2 | 1.7 | 16.6 | 1.8 | — |
| North Dakota | 100.0 | 93.5 | 0.1 | (*) | — | 6.4 | — |
| South Dakota | 100.0 | 41.5 | 0.1 | 0.1 | — | 58.2 | — |
| Nebraska | 100.0 | 59.0 | 0.1 | 1.3 | 35.0 | 4.5 | — |
| Kansas | 100.0 | 72.5 | 0.2 | 9.2 | 16.1 | — | — |
| West North Central | 100.0 | 74.6 | 0.4 | 2.3 | 19.3 | 4.3 | 0.2 |
| Delaware | 100.0 | 60.5 | 25.0 | 14.5 | — | — | — |
| Maryland | 100.0 | 59.2 | 10.3 | 3.2 | 23.6 | 3.7 | — |
| District of Columbia | 100.0 | — | 100.0 | — | — | — | — |
| Virginia | 100.0 | 44.8 | 4.2 | 2.3 | 48.6 | (0.1) | — |
| West Virginia | 100.0 | 99.2 | 0.3 | — | — | 0.5 | — |
| North Carolina | 100.0 | 56.0 | 0.2 | 0.3 | 36.3 | 7.2 | — |
| South Carolina | 100.0 | 33.2 | 0.1 | 1.4 | 61.7 | 3.6 | — |
| Georgia | 100.0 | 66.1 | 0.1 | 0.1 | 28.6 | 5.1 | — |
| Florida | 100.0 | 46.6 | 23.0 | 14.3 | 15.7 | 0.2 | — |
| South Atlantic | 100.0 | 57.4 | 7.2 | 4.3 | 28.3 | 2.8 | — |
| Kentucky | 100.0 | 95.0 | 0.1 | — | — | 4.6 | — |
| Tennessee | 100.0 | 63.1 | 0.2 | — | 22.4 | 14.2 | — |
| Alabama | 100.0 | 68.1 | 0.1 | 0.5 | 16.7 | 12.6 | — |
| Mississippi | 100.0 | 37.5 | 1.6 | 21.7 | 39.2 | — | — |
| East South Central | 100.0 | 71.8 | 0.3 | 2.1 | 16.1 | 9.7 | — |
| Arkansas | 100.0 | 51.0 | 0.2 | 6.5 | 33.0 | 9.3 | — |
| Louisiana | 100.0 | 33.1 | 0.1 | 42.4 | 24.4 | — | — |
| Oklahoma | 100.0 | 58.0 | — | 37.6 | — | 4.1 | — |
| Texas | 100.0 | 49.5 | 0.1 | 41.0 | 6.3 | 0.9 | 0.1 |
| West South Central | 100.0 | 48.2 | 0.1 | 37.3 | 12.3 | 2.0 | 0.1 |
| Montana | 100.0 | 57.3 | 0.1 | 0.1 | — | 42.3 | 0.2 |
| Idaho | 100.0 | — | — | — | — | 100.0 | — |
| Wyoming | 100.0 | 97.9 | 0.2 | — | — | 1.9 | — |
| Colorado | 100.0 | 93.2 | 0.1 | 1.3 | — | 5.4 | — |
| New Mexico | 100.0 | 88.3 | 0.1 | 10.8 | — | 0.9 | — |
| Arizona | 100.0 | 48.4 | 0.1 | 3.3 | 37.6 | 10.6 | — |
| Utah | 100.0 | 95.6 | 0.2 | 1.4 | — | 2.0 | 0.6 |
| Nevada | 100.0 | 77.7 | 1.2 | 9.6 | — | 11.5 | — |
| Mountain | 100.0 | 73.3 | 0.2 | 3.1 | 10.1 | 13.2 | 0.1 |
| Washington | 100.0 | 7.6 | — | — | 4.2 | 87.7 | 0.3 |
| Oregon | 100.0 | 6.1 | — | 2.5 | 3.2 | 88.2 | — |
| California | 100.0 | — | 0.6 | 41.9 | 30.1 | 20.0 | 7.5 |
| Pacific | 100.0 | 4.2 | 0.2 | 17.9 | 14.7 | 59.7 | 3.2 |
| Alaska | 100.0 | 7.6 | 9.5 | 62.0 | — | 20.9 | — |
| Hawaii | 100.0 | — | 99.7 | — | — | 0.3 | — |
| Alaska & Hawaii | 100.0 | 2.8 | 68.4 | 22.9 | — | 7.9 | — |

Note: Total may not equal sum of components due to independent rounding.

† Excludes petroleum coke.

‡ Includes petroleum coke.

* Less than one tenth of one percent.

** Includes generation by geothermal, wood, waste, wind and solar.

p Preliminary. () Denotes negative value.

Source: U.S. Department of Energy, Energy Information Administration, Monthly Power Plant Report, (EIA-759), as shown in Table 23.

ESTIMATES OF IMPACT OF BTU
TAX ON ELECTRIC RATES
Selected Public Power Systems

Percentage Price Increase For Electricity
Occasioned By Full Implementation of Btu Tax

| <u>Utility</u> | <u>Total System</u> | <u>Wholesale Sales</u> | <u>Retail Sales</u> | <u>Res.</u> | <u>Comm.</u> | <u>Industrial</u> |
|-------------------------|-------------------------|----------------------------|-------------------------|-------------|--------------|-------------------|
| <u>ARIZONA</u> | | | | | | |
| Salt River Project | 3.1 | | | 2.7 | 3.2 | 4.6 |
| <u>ALABAMA</u> | | | | | | |
| A'ta. Mun. Elec. Auth. | | 5.1 | 3.8 | | | |
| <u>CALIFORNIA</u> | | | | | | |
| Alameda | | | 1.9 | | | |
| Burbank | | | 3.5 | | | |
| Glendale | | | 3.2 | | | |
| Imperial Irr. Dist. | | | 3.4 | | | |
| Los Angeles | 4.5-5.0 | | | | | |
| Modesto Irr. Dist. | 3.76 | | | | | |
| Pasadena | 3.01 | | | | | |
| Redding | | | 3.3 | | | |
| Riverside | | | | 3.02 | | |
| Sac. Mun. Util. Dist. | | | 2.16 | | | |
| Vernon | 5.1 | | | | | |
| <u>COLORADO</u> | | | | | | |
| Platte River Pwr. Auth. | 9.0 | | | | | |
| Colorado Springs | | | | 4.2 | | |
| <u>CONNECTICUT</u> | | | | | | |
| Groton | 6.8 | | | | | |
| Conn. Mun. Elec. Energy | 6.8 | | | | | |
| <u>FLORIDA</u> | | | | | | |
| Fla. Mun. Pwr. Agency | | 6.03 | | | | |
| Jacksonville | 4.12 | | | | | |
| Key West | | | 4.78 | | | |
| Lakeland | | | 3.77 | | | |
| <u>GEORGIA</u> | | | | | | |
| Mun. Elec. Auth. of GA. | | 4.8 | | | | |
| <u>INDIANA</u> | | | | | | |
| Ind. Mun. Pwr. Agency | | 5.5 | 4.2 | | | |
| Cedar Falls | | | 6.3 | | | |
| Muscatie | | | 6.7 | | | |

| <u>Utility</u> | <u>Total System</u> | <u>Wholesale Sales</u> | <u>Retail Sales</u> | <u>Res.</u> | <u>Comm.</u> | <u>Industrial</u> |
|-----------------------------|-------------------------|----------------------------|-------------------------|-------------|--------------|-------------------|
| <u>KENTUCKY</u> | | | | | | |
| Owensboro | | | 7.5 | | | |
| <u>LOUISIANA</u> | | | | | | |
| Lafayette | | | 4.65 | | | |
| La. Energy & Pwr. Authority | | 6.05 | | | | |
| <u>MASSACHUSETTS</u> | | | | | | |
| Reading | | | 1.33 | | | |
| <u>MICHIGAN</u> | | | | | | |
| Lansing | | | 4.1 | 3.6 | | |
| <u>MINNESOTA</u> | | | | | | |
| Rochester | | | 3.6 | | | |
| So. Minn. Mun. Pwr. Agency | | 10.8 | | | | |
| Columbia | | | 4.6 | | | |
| Sikeston | 7.45 | | 5.2 | | | |
| Springfield | | | | | | |
| <u>NEBRASKA</u> | | | | | | |
| Lincoln | | | 6.0 | | | |
| Neb. Pub. Pwr. Dist. | 7.0 | | | 3.9 | | |
| <u>NORTH CAROLINA</u> | | | | | | |
| Fayetteville | | | | 4.12 | 6.56 | 7.40 |
| N.C. E. Mun. Pwr. Agency | | 3.6 | 3.0 | | | |
| N.C. Mun. Pwr. Agency 1 | | 4.5 | 3.3 | | | |
| <u>OKLAHOMA</u> | | | | | | |
| Okla. Mun. Pwr. Authority | 6.0 | | | | | |
| <u>OREGON</u> | | | | | | |
| Central Lincoln PUD | 6.9 | | | 5.3 | 5.9 | 6.0 to 9.0 |
| <u>SOUTH CAROLINA</u> | | | | | | |
| Santee Cooper | 5.88 | | | 3.92 | | |
| <u>SOUTH DAKOTA</u> | | | | | | |
| Heartland Con. Pwr. Dist. | 10.42 | | | | | |
| Mo. Basin Mun. Pwr. Agency | | 6.4 | | | | |
| <u>TENNESSEE</u> | | | | | | |
| Memphis | 5.8 | | | | | |
| Knoxville | 5.9 | | | | | |
| <u>TEXAS</u> | | | | | | |
| Lower Colo. Rvr. Auth. | | | 3.37 | | | |
| San Antonio | 4.71 | | | 4.19 | 4.57 | 6.00 |
| <u>UTAH</u> | | | | | | |
| Utah Mun. Pwr Agency | | | 4.59 | | | |

| <u>Utility</u> | <u>Total System</u> | <u>Wholesale Sales</u> | <u>Retail Sales</u> | <u>Res.</u> | <u>Comm.</u> | <u>Industrial</u> |
|------------------------|-------------------------|----------------------------|-------------------------|-------------|--------------|-------------------|
| WASHINGTON | | | | | | |
| Chelan Co. PUD | 15.0 | | | | | |
| Clark Co. PUD | | | 8.0 | | | |
| Cowlitz Co. PUD | 11.2 | | | | | |
| Grant Co. PUD | | | 12.9 | | | |
| Grays Harbor PUD | 5.81 | | | | | |
| Seattle | 6.45 | | | | | |
| Snohomish Co. PUD | 6.82 | | | | | |
| WISCONSIN | | | | | | |
| Marshfield | | | 6.0 | 5.5 | | 7.1 |
| Wisc. Pub. Pwr. System | 8.0 | | | | | |
| PUERTO RICO | | | | | | |
| P.R. Elec. Pwr. Auth. | 6.74 | | | | | |

Source: Compiled from individual utility preliminary estimates filed with the American Public Power Association in February and March 1993.

PREPARED STATEMENT OF MELANIE L. GRIFFIN

Mr. Chairman and members of the Committee, thank you for this opportunity to share the views of the Sierra Club on the Administration's proposed BTU energy tax. I am here today on behalf of the Sierra Club's 600,000 members and I am also representing the Natural Resources Defense Council, the Union of Concerned Scientists and Friends of the Earth.

The Sierra Club has long been interested in the use of tax policy to protect the environment, and we are very encouraged by the recent activity in this area. U.S. tax policy has historically encouraged polluting industrial activities and natural resource exploitation. It's time to reverse this trend and begin to use tax policy to encourage pollution prevention and energy efficiency and conservation.

To that end, Sierra Club joined with a number of other environmental organizations in suggesting that President Clinton include an energy tax in his plan for economic recovery. When the President presented his economic program, we were very encouraged to see that he had indeed include an energy tax. While not perfect, the President's tax proposal represents a good first step towards reducing our wasteful use of polluting energy.

THE COSTS TO SOCIETY OF WASTEFUL ENERGY USE

External energy costs in the form of air and water pollution, land destruction, oil spills, and military risks are already being borne by the American public. And these costs could pale in comparison to the future costs of global warming and nuclear plant decommissioning and waste storage. While energy industries may be able to assume away these costs, society cannot. Including environmental costs in energy prices would help to correct these market failures. It is time to begin to incorporate the social costs of energy production, distribution and use into the market pricing of energy.

Global Warming

The potential effects of global warming are tremendous, from coastal flooding and regional droughts to species extinction and agricultural and hydrological chaos. We cannot know exactly what will happen, or when. But in 1990, a group of scientists, including 700 members of the National Academy of Sciences and 49 Nobel Laureates wrote to President Bush asking that action to curb global warming "be initiated immediately." Despite remaining uncertainties, the scientists called global warming "the most serious environmental threat of the 21st century" and warned that "uncertainty is no excuse for complacency."

A well-designed energy tax can be an important component in a comprehensive plan to reduce carbon dioxide (CO₂) emissions and curb global warming. CO₂ from the burning of fossil fuels is the major contributor to the greenhouse effect, accounting for over half of the global warming problem. As the world's largest emitter of CO₂, the U.S. has a special responsibility to reduce emissions. An energy tax will reward investments in efficiency and discourage energy waste in the transportation, electric utility, and industrial sectors of the economy. It is imperative that the U.S. act quickly to take the lead on this critical international problem.

INTERNATIONAL COMPETITIVENESS AND ECONOMIC GROWTH

Energy taxes can give U.S. industries the push they need to fully explore and implement energy efficiency measures and renewable energy sources. Unlike Japan and several Western European nations, the U.S. has done little to foster international exports of these technologies. Many solar, wind and efficiency technological innovations originated in this country, but promoters were forced to go overseas for funding. As the international community begins to confront global warming, the U.S. must take back the lead in developing and marketing these technologies.

The U.S. spends about \$440 billion annually on energy, about 11% of our Gross National Product. (1) This is almost double the percentage of the Japanese economy. This higher energy usage results in higher product costs and lower competitiveness. But foreign producers, who face higher energy prices and energy taxes, have penetrated domestic markets with affordable, efficient cars and appliances. Even after the Administration's P U tax is fully implemented in 1996, prices for all energy sources will remain lower than our European and Japanese competitors. (2)

It is also important to note that low energy prices are not associated with faster rates of economic growth, lower rates of inflation or a favorable balance of trade. (3) Similarly, high energy consumption is not necessary for economic growth. In 1989, the U.S. used only 7% more energy than it did in 1973, yet the GNP was about 46% higher (and there were 20 million more homes and 50 million more vehicles.) (4) If the economy were still operating at 1973 efficiency levels, the U.S. would be losing about \$180 billion per year and pumping about 50% more CO₂ into the atmosphere than it currently does. (5)

A VALUE ADDED TAX VERSUS THE ENERGY TAX

Some have called for a value added tax (VAT) instead of the Administration's proposed BTU tax. A VAT is not helpful environmentally and we do not believe it makes economic sense when compared to energy taxes. First, a VAT is levied on positive activity. It taxes the value added to a product at each stage of production - things like wages and profits that we would like to see increase. It makes much more sense to tax an activity we would like to discourage, like wasteful energy use which causes pollution.

Secondly, a VAT creates distortions in the economy because different industries have varying abilities to pass along their increased costs. If a company produces an essential commodity or a large market share of its product, it may be able to pass along all increased costs. Industries under more competitive pressure may not be able to do so. In contrast, an energy tax is a corrective tax - it corrects market failures by including societal energy costs in the price of energy.

THE ADMINISTRATION'S PROPOSED BTU TAX

We have urged the Administration to ensure that their energy tax meets three criteria. We recommended that the tax be designed to encourage cleaner fuels and efficiency and that it be set at high enough levels to substantially benefit the environment. It is also critical that the tax contain offsets for Americans with lower incomes.

We believe that the BTU tax approach with exemptions for emerging renewable energy sources is an appropriate framework on which to build. The extra surcharge on oil recognizes that our country bears many social costs as a

result of our oil addiction - costs like military protection of overseas oil supplies, oil spill cleanup, and air and water pollution.

The President's proposed BTU tax is set at very modest levels. It is important to note that the positive environmental effects of the tax are enhanced by other environmental initiatives contained in the Administration's Budget Resolution and economic stimulus package. When the tax revenue is recycled into programs such as Federal Energy Management, public transit, low-income weatherization and renewable energy development, the environmental benefits rise substantially. As it is, the tax alone may result in a 2% decrease in energy use by the year 2000. The environmental benefits of the tax would increase if the tax rates were increased.

Just as the Budget Resolution and the stimulus package will enhance the environmental character of the BTU tax, so should some of the components of the National Energy Policy Act of 1990. The 1990 Act contains incentives for improved energy efficiency, renewable energy sources, and demand-side management in the utility sector.

Encouraging energy efficiency and emerging renewable energy sources will help to advance our national goals of carbon dioxide stabilization and pollution prevention. It will also help to reduce local conflicts as utilities opt to invest in efficiency and conservation rather than in the construction of controversial new polluting power plants.

The Administration was also careful to provide offsets for families with lower incomes. Phased-in increases in the Food Stamp program and the Low-Income Home Energy Assistance Program (LIHEAP) complement the BTU tax. In addition, the President's economic plan includes an expansion of the Earned Income Tax Credit (EITC) to ensure that low-income families are not burdened. We must also take into account the fact that energy pollution itself is very regressive. Disadvantaged communities bear much of the burden because polluting operations like coal-fired power plants and nuclear waste facilities are likely to be located in low-income areas.

Another attractive aspect of the President's BTU tax is that all energy consumers can legally avoid paying the tax and simultaneously help the environment. An industry can invest in more efficient motors, a business can invest in efficient lighting systems, and homeowners can add insulation. Commuters can opt to use public transit and purchase more fuel efficient vehicles. This approach should encourage more long-term investment in efficiency and conservation throughout the economy.

Overall, the Administration has proposed a well-designed energy tax. We do have serious concerns, however, with a number of changes in the proposal as reflected in the modified BTU tax released by the Treasury Department on April 1, 1993.

PANDORA'S BOX OF EXEMPTIONS

We believe that all forms of energy use should be taxed, with the exception of emerging, truly renewable energy sources like solar and wind power. Each exemption provided for an industry or a fuel source compromises the environmental integrity of the BTU tax and risks regional equity. And of course at some point, the revenues generated by the tax plan would be seriously reduced by multiple exemptions. The tax as originally proposed achieved a delicate regional and environmental balance which should not be compromised.

Alcohol Fuels

The BTU tax now contains an exemption for ethanol, methanol, Etb and MTBE. We believe this is bad environmental and fiscal policy. There is no environmental justification for these exemptions, and we fear the door is now open for exemptions for other special interests.

Ethanol production is very energy intensive and requires the heavy use of fossil fuels and nitrogen fertilization. This results in full-fuel cycle carbon dioxide emissions that may be even greater than gasoline emissions. (6) Large-scale production of corn and sugar are also detrimental to water quality and wise land use. The volatility of ethanol mixtures contributes to ozone pollution during the summer months. Given these environmental drawbacks and the fact that ethanol is already exempt from fuel excise taxes (resulting in a \$7mmBTU subsidy,) there is no excuse for further breaks for the ethanol industry.

Methanol is a fossil-based fuel and deserves no exemption. It comes with its own set of environmental problems, including formaldehyde emissions and greenhouse gas emissions when made from coal.

We support taxing alcohol fuels at the petroleum rate of \$.599 per million BTUs. At the very least, these fuels should be taxed at the straight BTU tax rate of \$.257 per million BTUs, as recommended by Senata Energy Committee Chairman J. Bennett Johnston in a March 23 letter to Chairman Moynihan.

Feedstocks

The exemption for non-fuel uses of fossil fuels is potentially a giant loophole through which pollution and revenue could flow. We urge the committee to give very careful consideration to the feedstock exemptions. We recommend a rebate program for non-fuel uses at the end of the production process rather than an exemption early in the process. This would ensure that only the percentage of the fuel used for non-fuel purposes is exempted. Rebates should be based on the mass of the original fuel that is actually physically incorporated into the final product.

Fuels used to produce process heat or drive chemical reactions should not be exempted from the BTU tax. Electricity used in aluminum smelting is used to cause a chemical reaction - it is not incorporated into the final product at all. Likewise, metallurgical coal used in steelmaking should not be exempted because less than ten percent of the carbon in metallurgical coal ends up in the steel. Fertilizer manufacturers use natural gas to produce ammonia, and some of the hydrogen from the gas is incorporated into the ammonia. But even if all the hydrogen were incorporated into the final product, this would still only be about 25% of the original fuel weight and should only result in a 25% rebate.

Municipal Solid Waste

The exemption for municipal solid waste incineration is particularly egregious, both fiscally and environmentally. Waste incinerators burn up valuable energy, materials and dollars, and threaten public health. In addition, petrochemicals used in plastics would receive a double exemption, once as a feedstock and again if burned in municipal trash.

Waste incinerators emit highly toxic heavy metals and organic chemicals like dioxins. Toxics released into the air or concentrated in ash are much more easily absorbed into the human body than before incineration. Typically, 30-40% of the weight of garbage that is burned ends up as ash which must be landfilled.

Allowing solid waste to be an untaxed fuel would impede the development of truly energy-saving recycling programs, which should be a national goal. The initial capital outlay for incinerator construction, not including operating costs, far exceeds that of establishing an effective recycling program. Energy produced by garbage incinerators costs up to 50% more per kilowatt-hour than energy from conventional power plants and incineration generates far less energy than recycling the same materials.

Home Heating Oil

We do not support the Administration's move to lower the tax rate on home heating oil. This exemption damages the regional equity in the plan and removes the incentive for a transition to cleaner natural gas in the Northeastern U.S. It also introduces the added administrative complication of determining whether oil is being used for residential or commercial heating.

WHO'S NEXT IN LINE FOR EXEMPTIONS?

Now that exemptions have been granted to a number of special interests, we are concerned that more exemptions are just around the corner. We strongly urge the committee to resist further exemptions. The environmental balance of the tax has already been damaged by existing exemptions. We urge you to consider closing the loopholes in the tax by returning to the principle of taxing all energy consumed in the economy, exempting only those emerging energy sources which are truly renewable.

Hydropower

We strongly support the tax on hydroelectricity contained in the Administration's proposal. Although hydropower releases no pollution into the atmosphere, it has serious environmental consequences. It has led to major declines in fisheries, species diversity, riparian habitat and water quality all across the country. In the Pacific Northwest, dams prevent salmon and steelhead from reaching about one-third of their original habitat in the Columbia River basin. In Michigan, over 2,000 mainstem river miles are blocked by dams. In New England, hydropower dams essentially eliminated historic runs of salmon, shad and alewives until restoration efforts began.

Taxing hydropower is also essential to the regional balance of the President's tax proposal. Some states get almost all their power from hydroelectricity, and reducing their tax rate (or exempting them) would increase the burden on other states. Because about half our hydropower comes from heavily subsidized federal facilities, electricity rates in these regions are already much lower than the national average.

Aluminum Industry

I reiterate that we oppose any exemption for the aluminum industry. The proper way to determine whether energy is actually being used as a non-fuel source is to test whether the chemical elements in the fuel are present in the final product. Following this test, aluminum is not entitled to a rebate because the energy used to drive the chemical smelting process is not present in the final aluminum.

WHO PAYS, WHEN AND WHERE?

A major goal of the environmental community is improving energy efficiency in all sectors of the economy. Thus, we believe that all energy users should bear the added costs of the energy tax. The tax should be assessed, and incorporated as a cost of doing business, at every point in the production and distribution process.

Collection Point

The tax should be assessed as far upstream as possible to encourage efficiency throughout the entire energy production process. We believe that the tax should be collected before the oil refinery and before the gas wellhead or pipeline, not at the tailgate as proposed by the Treasury Department on April 1. Collecting the tax before refining and pipeline transport would improve the efficiency of the refinery and pipeline process. At the very least, the Administration should adjust the tax rate upward to compensate for the efficiency gains not realized during refining and transport.

Utility Passthrough

We also oppose a forced passthrough of costs by electric utilities to ratepayers. Electric utilities should consider the high external costs of coal and nuclear power when making investment decisions. We believe a primary objective of the BTU tax is to provide incentives for investments in cleaner energy sources and efficiency improvements. States already have provisions to allow utilities to pass through legitimate costs, and this process should not be overridden.

While end-users should bear some of the costs of the energy tax, they should not automatically bear the brunt. Homeowners can make some efficiency choices to reduce their bills, but they cannot switch fuels or make efficiency investments for their utilities. Utilities are sophisticated operations with the financial and planning capabilities to make these long-term investment choices when facing increased energy costs.

Thank you for the opportunity to testify today. We look forward to working further with the Committee.

NOTES

1. Congressional Research Service Issue Brief, "Energy Conservation: Technical Efficiency and Program Effectiveness," October, 1991.
2. International Energy Agency, Energy Prices and Taxes 1992.
3. World Resources Institute, "Money to Burn? The High Costs of Energy Subsidies," October, 1987.
4. "Energy Conservation Trends: Understanding the Factors that Affect Conservation Gains in the U.S. Economy," U.S. Department of Energy, September, 1989.
5. Congressional Research Service Issue Brief, "Energy Conservation: Technical Efficiency and Program Effectiveness," October, 1991.
6. "Reducing Greenhouse Gas Emissions with Alternative Transportation Fuels," Environmental Defense Fund, May, 1991.

PREPARED STATEMENT OF ORRIN G. HATCH

Mr. Chairman, I am pleased that we are holding this hearing today on this very important topic, the President's energy tax proposal. I look forward to the remarks of Secretary Bentsen and of the industry panel.

When the President announced his deficit reduction plan in February, he told us that the cost of the Btu tax on a family of four earning \$40,000 per year would be \$17 per month, or \$204 per year. This \$204 extra per year was represented as an almost harmless minimal sacrifice that the Administration felt the average American household should gladly contribute for the cause of deficit reduction.

However, Mr. Chairman, the latest information that my office received from the Treasury Department now indicates that the impact for a family of four of the energy tax on my home state of Utah will be at least \$416 per year.

I am very concerned about this new estimate, Mr. Chairman. By Treasury's own admission, the impact of the energy tax on a family in Utah will be more than double what was estimated to be just two months ago. Just last fall, Americans were led to believe that the Clinton plan would not raise taxes for anyone but the very wealthy. Now this proposal has doubled its burden on the average Utah family in just two months.

I realize that the President's plan contains some proposals to ease this burden on the very poor. For example, the proposal would expand the earned income tax credit and increase funding for food stamps. I believe, however, that what relief we give with the right hand should not be taken away with the left with new taxes on energy.

It is naive to think that this tax will not place a significant burden on Utah families. For one thing, the offsets would not cover every low-income family. Only families with dependent children would qualify for the EITC expansion, and only those with very low incomes would qualify for the other provisions.

The Treasury's latest description of the energy tax contains a chart that indicates that Utah families will only have to pay .63 percent more of their incomes for this tax. This looks like more hocus pocus to me. Recently released family income data show that families in Utah counties will pay a far higher portion of their incomes

for this proposed tax hike. A Salt Lake County family, for example, will pay 1.2 percent of its income in increased energy taxes, almost double the Treasury estimate. A family living in San Juan County, in the southeastern corner of Utah, would pay 2.2 percent of its income in new energy taxes. And these figures are based on total family income, not disposable income, making my figures conservative.

As bad as these figures look, Mr. Chairman, they still don't tell the entire story for Utah families on how this tax will affect them. Unlike the taxes most Americans are used to paying, the Btu tax will be disguised as higher prices. These higher prices will be on a variety of products and services that all of us purchase every day. Utility bills, of course, will go up. So will the price of gasoline. But so will the cost of food, of a new car, of a can of paint, or of a pair of shoes for the kids.

The bottom line is that we aren't getting the full story about the impact of this tax. It will be much worse than it appears.

The operating expenses of every business in Utah will go up because of the Btu tax—some more than others. Manufacturers will have to pass the additional costs on to their customers, or if they cannot, lay off workers. Farmers will have to charge more for food, or get out of farming. A service business will have to charge for more its services, or again, go out of business or lay off workers.

When assessing the impact of the energy tax, the Administration has obviously not taken into account the macroeconomic effects on prices and employment. The fact is, this Btu tax will lead to lost jobs. The National Association of Manufacturers estimates 610,000 lost jobs. The Petroleum Institute estimates 700,000 job losses. Some of these jobs will be lost in Utah. How many? No one knows. And, what do I say to the family who loses a job because of this tax? That this is their contribution to the deficit? The fact is, Mr. Chairman, and I say respectfully to you, Mr. Secretary, is that the revenue you expect to obtain from this tax has to come from somewhere and that somewhere is from the pockets of every single American, rich and poor.

I look forward to the testimony today.

PREPARED STATEMENT OF JOHN HEMPHILL

I. INTRODUCTION

Good morning, Mr. Chairman. I am John Hemphill, executive director of the business council for a sustainable energy future. I appreciate the opportunity to appear before you today to present the business council's views on the administration's energy tax proposals.

The business council for a sustainable energy future is a newly chartered organization comprised of business leaders from the energy efficiency, renewable energy, natural gas and utility industries that share a commitment to pursue a new energy strategy for the 1990s and beyond. This new strategy is designed to realize the nation's economic, environmental and national security goals through the rapid deployment of efficient, non- and low-polluting energy technologies. The expanded reliance on energy efficiency, renewable energy and nature at gas as the three pillars of an energy strategy will strengthen the economy and enhance the environment.

To achieve this end, the business council supports energy related policies and programs at the federal and state levels that: (1) improve energy efficiency in all sectors of the economy; (2) accelerate the commercialization of renewable energy resources; and (3) promote the use of natural gas in energy production and end use.

The business council is pleased with the prominent role President Clinton has given to energy efficiency, renewables, natural at gas and the reduction of oil imports in fashioning his economic package. We believe that this package signals a major change in national energy policy—the recognition of the need to transition to clean, efficient energy sources. The business council welcomes this change in direction.

Although we have interests in many provisions of the administration's proposed economic package, my testimony today will focus on the revenue portion of the package and, in particular, the broad-based energy tax.

In addition, we also have concerns about the implications of the proposed investment tax credit as it would be implemented under current tax law. We believe that current tax policy may inadvertently reduce the benefits of the investment tax credit for certain industries that need it the most.

II. ENERGY TAXES

As a part of the deficit reduction portion of his economic package, President Clinton has proposed a broad-based energy tax designed to raise more than \$20 billion

annually when fully phased-in. According to the administration, in addition to raising revenue, "energy taxes will encourage conservation by making energy more expensive, reducing pollution, and decreasing the country's dependence on foreign energy suppliers." The business council clearly supports these goals.

There are many types of taxes that offer the opportunity to raise revenues while also serving to support energy and environmental policy objectives. While members of the business council may have preferred other formulations, we recognize that no approach is without criticism. The business council is ready to support President Clinton's broad-based energy tax proposal in recognition that the tax is an important step in the direction of a sustainable energy future. In particular, we applaud the exclusion of renewable energy resources from the tax.

The business council's support for this tax is not without reservations, however. First, the tax, when fully phased in, will result in only modest improvements in encouraging energy conservation. In this regard, it may be appropriate to provide energy tax credits to consumers to further encourage energy conservation. Second, we believe the energy tax could be structured to more appropriately reflect the differential environmental and energy security impacts of various energy sources. In this regard, we recommend that serious consideration be given to adjusting this tax over time to better support the administration's overall energy and environmental goals.

Third, the business council has concerns with the proposed collection point for the tax on natural gas. The administration proposes to collect the tax on natural gas at the "city gate." However, applying the tax at this point would expose the natural gas industry to unwarranted financial risks associated with collecting the tax, due to possible regulatory constraints on passing the tax on to the ultimate consumer.

A similar situation exists with respect to independent power producers that have long term, fixed priced supply contracts which would prevent these producers from passing along the tax, if it were imposed on their fuel inputs. The administration has proposed a solution to the independent power producer problem by moving the collection point to require the utility that receives the electricity to pay the tax. This approach helps ensure the tax is born by the ultimate user of the resource. This approach is consistent with the business council's principle that "energy taxes should be imposed in such a way so as to maximize their energy conservation and environmental benefits."

The natural gas industry has proposed a solution to the collection point problem on gas which the business council supports—the tax should be assessed on the end user of the gas and collected by the seller. This approach ensures the realization of the full efficiency and environmental benefits of the tax and minimizes unintended effects. The administration rejected the gas industry's proposal. We urge that you reconsider the industry's collection point proposal.

Fourth, I would like to point out our displeasure with the proposal to exempt ethanol and methanol from the energy tax and to exempt home heating oil from the supplemental tax on petroleum. These exemptions discriminate against natural gas, which is in direct competition with these fuels for important new markets.

Finally, I would like to address an implementation concern of some of our members. The administration proposes to exempt nonfuel use of fossil fuels including natural gas liquids. Under the administration's proposal the tax on these liquids is to be collected at the processing plant. However, since approximately three quarters of these products are used as feedstocks, imposition of the tax at the processing plant would have the unintended effect of taxing feedstock fuels. The solution to this problem is to impose the tax at the point these products are odorized for commercial fuel use.

III. INVESTMENT TAX CREDIT

Turning now to the investment tax credit issue, the business council supports the incentives and exclusions proposed and already in the law for renewable energy investments. However, we believe that several additional technical revisions in the manner in which the investment tax credit operates could further the administration's objectives in providing an investment tax credit.

First, we urge that the amount of the ITC that can be used against the alternative minimum tax be increased. Existing law limits investment tax credit utilization to only 25 percent of a company's alternative minimum tax liability, reducing substantially the value of these new credits for many small, start-up companies as well as the majority of capital intensive industries that have been in the AMT tax position throughout most of the recession.

Second, many companies and industries will receive a considerably reduced benefit from a new investment tax credit either because they are currently subject to the alternative minimum tax, they have unused ITCS, or they anticipate consider-

able economic losses associated with developing new technologies or starting up new high-risk business ventures. For these companies, we recommend that any investment tax credits that would otherwise expire before use due to the interaction of the alternative minimum tax system and the regular tax system be converted into alternative minimum tax credits rather than be lost completely.

Third, the council urges that there be no reduction in the production tax credit for wind and closed-loop biomass investments provided in the national energy policy act of 1992 that would otherwise qualify for the investment tax credit. Clearly, these investments require the full tax benefits to bring these valuable new energy technologies to market and to treat them similarly to the other renewable technologies. We recommend either that the restrictive language contained in the existing production tax credit be deleted or that the implementing legislation of the investment tax credit provide that the production credit not be reduced for renewable energy investments that otherwise qualify for the investment tax credit.

We would be pleased to work with committee staff on these issues and to submit written responses to any technical questions the committee may have.

IV. CONCLUSION

The business council appreciates the opportunity to address your committee on the broad-based energy tax proposal contained in the President's economic package. We support the President's effort to tackle the country's debilitating budget deficit while improving environmental quality. As business leaders concerned about the health of the U.S. economy, we believe that the country needs to follow a new energy path—for economic, environmental and security reasons.

The business council views the proposed broad-based energy tax as a good first step in addressing the dual challenges facing our country—economic revitalization and environmental enhancement. We stand ready to work with both the administration and congress in support of these efforts.

Thank you.

PREPARED STATEMENT OF PAUL R. HUARD

Thank you, Mr. Chairman. I am Paul Huard, Vice President for Taxation and Fiscal Policy of the National Association of Manufacturers [NAM]. On behalf of our more than 12,000 members, I am pleased to be here to discuss the Administration's energy tax proposals.

I. General Economic Implications

Before discussing specifics, I want to emphasize at the outset that NAM is fully supportive of President Clinton's deficit reduction goals. We believe he is correct in concluding that significant reduction of the federal budget deficit is absolutely essential if we are to achieve long-term economic growth and prosperity and a rising standard of living for all Americans. Just as importantly, the President has accurately described our need as a nation for less emphasis on immediate consumption and more emphasis on the private investment that is so essential to both productivity improvement and job creation.

Our great concern about the President's plan is that it will fail to achieve its desirable goals of reducing the deficit, creating jobs and increasing productivity-improving investments. One reason we think this will happen is that the plan relies far too much on tax increases to reduce the deficit, and far too little on spending cuts. While both spending cuts and tax increases will cause short-term economic contractions, spending cuts will result in smaller GDP losses and fewer job losses than an equivalent amount of tax increases.

Another cause for concern is that the stimulus implied by business tax incentives in the President's plan is considerably less than the offsetting business tax increases. Reductions in net business cash flow of the magnitude being proposed will significantly reduce both investment and jobs. Stated another way, the positive effects of modest or temporary incentives will be overwhelmed by the negative effects of large, permanent tax increases. This is especially relevant to the inquiry before this Committee today, since of the total of about \$243 billion in net revenue increases proposed by the President over the next five years, about \$72 billion—at least 30 percent of the total—would be derived from the proposed BTU-based energy tax.

NAM views this proposed BTU-based energy tax as an unfortunate choice. Although it appears to be a well-intentioned attempt to tax consumption, in reality it would amount to a major tax on industrial production. Our preliminary estimate is that at a minimum one-third (and possibly more) of the total BTU tax would fall directly on industrial production processes, i.e., would increase the cost of the energy used by American manufacturing firms in making their products. Thus, the tax would unilaterally increase the cost of U.S.-produced goods relative to foreign-produced goods, thereby impairing U.S. competitiveness in both domestic and overseas markets.

In order to evaluate the implications of the proposed BTU tax, we ran an econometric simulation using the Washington University Macromodel, over a period of six years (1993-1998). The simulations express the deviation in the path of the economy relative to current law implied by the energy tax. The results from our simulation are presented in Table 1 (in the appendix). Real GDP falls below trend as the tax is phased in. By the final year, output has been reduced by \$38 billion relative to its current law path. Among the components of GDP, the largest losses come in personal consumption expenditures (\$27 billion) and business fixed investment (\$18 billion). Because manufacturing is more energy-intensive than the economy as a whole, the losses in industrial production are proportionately about one-third larger than the reduction in GDP. The cost in employment is considerable. By the final simulation year, civilian employment is lower by 610,000 jobs.

The price level rises by just over 1 percent relative to current law. This is a conservative estimate. Some energy experts have argued that the magnitude of the tax increase is much larger than assumed by the Treasury. Because of this controversy, we also report our estimates for the average price of domestically-consumed energy. We find that energy prices would increase only a modest 3.5 percent in 1993, but would then surge by 9.2, 8.8 and 7.2 percent in the next three years, before slowing to a 3.1 percent increase in 1997 after the tax was fully phased in. The increase in prices causes Federal spending to increase, due to indexation, and thus has perverse effects on the fiscal deficit. The combination of higher Federal spending and lower collections of other tax revenues means that the dynamic improvement in the deficit is much smaller than the static revenue increase. By the final simulation year, the static revenue increase is in excess of \$22 billion, but the dynamic improvement in the deficit is just under \$10 billion.

In sum, the BTU tax does considerable damage to the economy, and is extremely inefficient at reducing the deficit. By comparison, while a general consumption tax, such as a value-added tax [VAT], would also imply a one-time rise in the price level, it is much more efficient at raising revenue since it raises output in the long run, while it also taps into the "underground" economy.

II. A Comparison of the BTU tax and the VAT

NAM believes that income from work, savings and investment is taxed too heavily under the federal tax system as it exists today, and agrees with the President that shifting more of the national tax burden onto consumption is desirable. In our view, however, this would be best achieved through a general national consumption tax—for example, a VAT—imposed at a uniform rate across the broadest possible base of both goods and services. A general tax on consumption would not penalize U.S.-based firms, while the proposed BTU tax would make American firms less competitive. Moreover, its burdens would be spread more equitably over the entire U.S. economy, rather than being unfairly concentrated on a single sector that is already suffering disproportionately from large non-tax burdens imposed by government fiat, such as the rapidly escalating costs of environmental regulation and the severely decreased opportunities for domestic exploration and production.

The BTU-Based Energy Tax. The Administration's proposal is to tax energy based on its heat content, as measured in British Thermal Units [BTUs]. This tax would be assessed at the rate of 25.7 cents per million BTUs on natural gas and coal and on hydroelectric and nuclear energy. Oil would be taxed at the rate of 59.9 cents per million BTUs. Non-fuel uses, such as industrial feedstocks, would not be taxed. Nevertheless, as already noted, the proposed BTU tax would still significantly increase the cost of U.S.-based industrial production via increases in the price of energy used in the manufacturing process. The Administration proposal contains no element that would attempt to impose a comparable cost increase on goods imported into the U.S., or that would attempt to remove such cost increases from goods exported from the U.S. This is understandable, since any such attempt would violate the General Agreement on Tariffs and Trade [GATT].

Value-Added Tax [VAT]. As typically structured, a VAT is a transaction-based tax that is imposed on the sales of goods by businesses at each stage of production and distribution, and on the sales of services as they are rendered. As commonly administered, each business taxpayer in the production/distribution chain collects VAT on its sales [i.e., outputs] but takes a credit for VAT paid on its purchases [i.e., inputs] from other businesses, remitting only the difference to the government. End-users, i.e., consumers who are final purchasers and thus do not resell, theoretically bear the full burden of the VAT. It is, therefore, usually viewed as equivalent in economic impact to a retail sales tax, the principal difference being that it is collected in installments rather than all at once. A VAT is imposed at the same rate on both domestically-produced and imported goods. Almost invariably, domestically-produced goods that are exported are not subjected to VAT. This treatment is fully consistent with GATT rules.

III. Differing Impacts of BTU and Value Added Taxes

On Consumers. It is difficult to generate quantitative comparisons here, but a number of generalizations are helpful. It is undisputed that lower-income taxpayers have to spend a larger proportion of their income on energy consumption [e.g., for home heating, transportation to/from work, etc.] than do higher-income taxpayers. A VAT, on the other hand, would apply not only to unavoidable or necessary purchases, but also to optional or discretionary purchases--luxuries, if you will. Admittedly, it is always possible to offset or neutralize the regressive impact of either a VAT or a BTU or other energy tax, for instance through refundable income tax credits. The fact remains, however, that there would be less regressivity to be so neutralized--and hence more net revenue to the government--under a VAT than under an energy tax of comparable size.

By Geographic Region. There are wide variations by state in the amount of energy used to generate a dollar of state economic output. It has been estimated that, on average, it takes 15,700 BTUs of energy to produce a dollar of state economic output. The range of energy intensiveness, however, is quite wide, running from 44,600 BTUs per dollar of output in Louisiana to less than one-fifth that amount--8,100 BTUs per dollar of output--in New York. Some intermediate figures include 34,600 BTUs per output dollar for Wyoming, 22,300 BTUs per dollar for Arkansas, 15,700 BTUs per dollar for Pennsylvania and 9,500 BTUs per dollar for Massachusetts. The states that would experience the most adverse consequences from the tax are listed in Table 2 (in the appendix).

Here again, quantitative comparisons with a VAT are not readily available. It is nonetheless safe to conclude that, given a reasonably broad base of taxable goods and services--one with as few exemptions as possible--the economic incidence of a VAT on economic output would show much narrower variations than would occur under a BTU tax or, for that matter, under any other type of energy tax, such as an ad valorem energy tax, a gasoline tax, a so-called carbon tax, etc.

By Specific Type of Business. Variations in the impact of a BTU tax by specific type of business will obviously be enormous. Using Department of Energy statistics based on a 1988 survey, the largest use of energy per dollar of value added occurs in petroleum refining (143.4 thousand BTUs per dollar), nitrogenous fertilizers (192.1), cement (150.7), paperboard (96.3), blast furnaces and steel mills (95.9), and primary aluminum (65.3). On average, manufacturing firms consume 12,100 BTUs per dollar of value-added. The energy-intensity of major manufacturing sectors is summarized in Table 3 (in the appendix). By comparison, most services are much less energy-intensive. A single rate VAT, on the other hand, increases the cost of all covered goods and services by the same proportion of value. Since the BTU tax will therefore fall more heavily on the manufacturing sector than on the service sector, it should be no surprise that we find this unfair and objectionable as a matter of basic principle.

An even wider economic interest is at stake, however, because exports of manufactured goods account for over 80% of U.S. merchandise exports, and are three times greater than service exports. Manufacturing exports have in recent years accounted for 30 to 40 percent of U.S. economic growth. Yet the cost increase in a manufactured product flowing from imposition of the BTU tax cannot, consistent with our treaty obligations under the GATT, be rebated or otherwise "backed out" of the cost of that product when it is exported. A BTU tax would, thus, unilaterally impair U.S. export competitiveness. A VAT, on the other hand, would not apply to exports of any kind, whether goods or services, and thus would have no negative impact on export competitiveness.

There is another important way in which a BTU or other energy tax is a mistake. The U.S. oil and gas extraction industry has been extraordinarily hard hit in the last decade, losing approximately 400,000 jobs. NAM believes it is wholly inappropriate to impose large tax burdens on the energy sector at a time when the government, through bans on offshore

drilling and failure to open the Arctic National Wildlife Refuge [ANWR], has severely restricted opportunities for domestic exploration and production of oil and natural gas. It has been estimated that the failure to open ANWR is by itself preventing the creation of 735,000 new jobs.

Internationally. As I have already mentioned, a BTU tax hurts U.S. competitiveness both here and abroad. It unilaterally makes U.S. production relatively more expensive than foreign production in both U.S. and overseas markets. Further, there is no viable way to remedy or adjust for these anti-competitive effects that would be consistent with our treaty obligations under the GATT. A VAT by its basic design [applied to imports into the U.S.; not applied to exports from the U.S.] fails to give rise to the type of anti-competitive effects inherent in a BTU or other energy tax and such basic design is fully consistent with the GATT. Indeed, the U.S. is now the only major industrialized nation that does not employ a VAT type of tax to raise a significant portion of its central government revenue.

It is important moreover to note that other large tax increases being proposed by the Administration—for example, the increases in corporate tax rates and the rise in employer payroll taxes for Medicare hospital insurance—also have anti-competitive effects identical to those of the BTU tax: they unilaterally place U.S.-produced goods at a price disadvantage both here and abroad, and there is no GATT-legal way to adjust for this. Retaining the BTU tax in the package would thus worsen an already bad situation.

Effect on the Economy. We have not compared the Administration's proposed BTU-based energy tax directly with a VAT since the VAT represents a much larger tax and should not be thought of as a way to achieve short-term deficit reduction, but rather in terms of a longer-term structural reform of the tax code. For instance, while the BTU tax proposed here would raise \$22 billion when fully phased-in, under a broadly-based VAT, some \$30 to \$40 billion in revenues would be raised for every percentage point of the tax. While we have not done a direct comparison, we have accumulated a fair amount of experience in recent years in simulating the effects on the economy of both energy taxes and broad-based general consumption taxes such as a VAT. Our main finding is that energy taxes generate large and persistent losses in real GDP and employment.

By comparison, while the VAT entails some short-term losses in consumption spending, over the same intervals for which energy taxes were simulated, the VAT would generate substantial improvements in economic activity, primarily through the channels of capital investment and net exports. Another way of saying this is that the economy will recover much faster under the VAT. The principal reason for this conclusion is that a BTU tax has a significant impact at the production level of the economy, whereas a VAT does not. In today's competitive world, a substantial portion of the increase in production costs will mean reduced capital formation and employment.

Impact on Energy Conservation/Security. A VAT admittedly would have no noticeable impact on energy conservation or national energy security. It is claimed, on the other hand, that the BTU tax would encourage energy conservation generally and also improve national energy security by decreasing our reliance on imported oil.

These claims are difficult to evaluate. Energy efficiency, measured in terms of thousand BTUs per dollar of constant dollar GDP, improved from 27.3 in 1972 to 20.43 in 1985, in the wake of successive increases in OPEC prices which together raised the cost of imported oil by about 1000 percent (400 percent in 1973-74, 150 percent in 1979-80). This would imply that a 142 percent increase in energy prices is required to reduce the energy-real GDP ratio by a single percentage point. By this benchmark, the BTU tax contemplated here would not raise relative prices enough to encourage much more conservation than is already taking place.

This issue is rendered even more complex, however, by the fact that even after the collapse in OPEC oil prices in 1986, energy efficiency continued to improve, from 20.43 in 1985 to 19.60 in 1989. Contrary to the claims of some environmental groups, the United States is still making steady progress toward energy efficiency. To the extent that these efficiency gains are still being made, it appears to be a poor tradeoff to try to accelerate them at the cost of lowering real growth and employment through a new tax.

IV. Conclusions

It seems clear that in nearly every respect a broad-based consumption tax, such as a VAT, is superior to the BTU-based energy tax that has been proposed by the Administration. Only in the case of its effect on energy conservation or security does the BTU tax hold an advantage, and that advantage is relatively weak. The many areas where the VAT holds the relative advantage are as follows:

1. The VAT does not have the anti-competitive effect that the BTU tax has in unilaterally raising price levels of U.S. goods in both home and overseas markets. The VAT as a matter of basic design is consistent with our international treaty obligations, whereas the anti-competitive effects of a BTU tax cannot be offset in a manner consistent with such obligations. The BTU tax will, therefore, tend to reduce exports, which in recent years have accounted for 30 to 40 percent of U.S. economic growth.

2. While all net tax increases cause economic contractions, a VAT is generally more benign than the BTU tax in terms of its effects on growth, employment, investment and productivity. While the VAT implies lower consumption spending in the short-term, energy-based taxes imply a simultaneous shock to both the price level and production costs, resulting in larger and more persistent GDP reductions. Moreover, in the long run, the VAT yields substantial gains in real GDP, primarily in capital investment and net exports.

3. The VAT is more even in its impact and creates fewer and smaller disparities than the BTU tax, whether compared on the basis of differing geographic regions, differing types of businesses, or differing economic sectors.

4. Manufacturing industries would be particularly hard-hit by the BTU tax, primarily because the tax would increase production costs. This would result in reduced investment and employment, and a loss in trade competitiveness. Industries that would be most adversely affected include primary metals, aluminum, chemicals, paper, cement, fertilizers, transportation, and the energy sector itself.

5. Because the taxable base is so much broader in the case of a VAT, this tax should be thought of primarily in the context of systematic structural reform of the tax code. Raising the same amount of revenue as the Administration's BTU-based energy tax would require a VAT rate of well under one percent, but a VAT makes little sense at this level. A better idea would be to impose a VAT at a higher rate, and use the revenues not just to reduce the deficit but also to reduce other harmful taxes. This would be no more complicated than putting a BTU tax in place, and done properly might well be considerably less complicated.

In conclusion, Mr. Chairman, I would urge the Congress to drop the Administration's proposal for a BTU-based energy tax, primarily because of its anti-competitive international effects and the disproportionate impact it would have on manufacturing industries and certain segments of the economy. We urge Congress to reduce the federal budget deficit to the maximum extent possible by comprehensive, enforceable restraints on federal spending. To the extent tax increases are still required for deficit reduction purposes, we believe that a broad-based general tax on consumption, such as a VAT, will do the least amount of harm to the economy, will avoid damage to our international competitiveness and, if properly adjusted so as to offset its regressivity, will be the most uniformly fair across all social, regional and economic sectors.

APPENDIX

TABLE 1

COMPARISON OF THE BTU TAX WITH CURRENT LAW

BASE: Current Law

| ALT: BTU Tax | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 |
|--------------|------|------|------|------|------|------|
|--------------|------|------|------|------|------|------|

GDP (billions of constant 1987 dollars)

| | | | | | | |
|--------------|---------|---------|---------|---------|---------|---------|
| Base | 5048.00 | 5201.01 | 5356.96 | 5514.37 | 5664.41 | 5805.65 |
| Alternative | 5047.88 | 5198.32 | 5342.81 | 5484.24 | 5625.43 | 5767.13 |
| Difference | -0.12 | -2.69 | -14.14 | -30.13 | -38.97 | -38.51 |
| % Difference | -0.00 | -0.05 | -0.26 | -0.55 | -0.69 | -0.66 |

Personal Consumption Expenditures

| | | | | | | |
|--------------|---------|---------|---------|---------|---------|---------|
| Base | 3391.59 | 3487.92 | 3593.19 | 3697.68 | 3800.11 | 3891.18 |
| Alternative | 3391.47 | 3485.99 | 3584.05 | 3678.52 | 3774.80 | 3863.74 |
| Difference | -0.11 | -1.93 | -9.14 | -19.16 | -25.31 | -27.44 |
| % Difference | -0.00 | -0.06 | -0.25 | -0.52 | -0.67 | -0.71 |

Business Fixed Investment

| | | | | | | |
|--------------|--------|--------|--------|--------|--------|---------|
| Base | 754.72 | 811.29 | 864.12 | 919.11 | 969.24 | 1011.34 |
| Alternative | 754.68 | 810.27 | 858.16 | 905.43 | 950.49 | 993.08 |
| Difference | -0.04 | -1.02 | -5.96 | -13.68 | -18.76 | -18.26 |
| % Difference | -0.00 | -0.13 | -0.69 | -1.49 | -1.94 | -1.81 |

Industrial Production (index)

| | | | | | | |
|--------------|--------|--------|--------|--------|--------|--------|
| Base | 111.80 | 117.14 | 121.97 | 126.56 | 130.99 | 135.40 |
| Alternative | 111.80 | 117.06 | 121.55 | 125.63 | 129.77 | 134.20 |
| Difference | -0.00 | -0.08 | -0.42 | -0.92 | -1.22 | -1.20 |
| % Difference | -0.00 | -0.07 | -0.35 | -0.73 | -0.93 | -0.89 |

Civilian Employment (million jobs)

| | | | | | | |
|-------------|--------|--------|--------|--------|--------|--------|
| Base | 118.95 | 121.12 | 123.33 | 125.55 | 127.58 | 129.30 |
| Alternative | 118.95 | 121.08 | 123.21 | 125.19 | 127.04 | 128.69 |
| Difference | -0.00 | -0.04 | -0.12 | -0.36 | -0.54 | -0.61 |

Price Level (GDP Deflator)

| | | | | | | |
|--------------|--------|--------|--------|--------|--------|--------|
| Base | 123.58 | 126.30 | 128.95 | 131.63 | 134.43 | 137.35 |
| Alternative | 123.59 | 126.39 | 129.34 | 132.41 | 135.48 | 138.40 |
| Difference | 0.01 | 0.09 | 0.39 | 0.78 | 1.05 | 1.05 |
| % Difference | 0.01 | 0.07 | 0.31 | 0.60 | 0.78 | 0.77 |

Federal Fiscal Deficit (billions of current dollars)

| | | | | | | |
|-------------|---------|---------|---------|---------|---------|---------|
| Base | -279.06 | -256.35 | -242.90 | -224.28 | -215.83 | -225.20 |
| Alternative | -278.62 | -252.80 | -236.61 | -216.01 | -206.28 | -215.84 |
| Difference | 0.44 | 3.55 | 6.29 | 8.27 | 9.54 | 9.36 |

APPENDIX

TABLE 2

ENERGY-INTENSITY OF SELECTED* STATE ECONOMIES

[In thousands of BTUs per dollar of gross state product]

| State | Energy-Intensity |
|----------------|------------------|
| Louisiana | 44.6 |
| Wyoming | 34.6 |
| North Dakota | 29.0 |
| Texas | 28.5 |
| West Virginia | 28.5 |
| Alaska | 28.4 |
| Montana | 26.9 |
| Mississippi | 26.0 |
| Oklahoma | 24.8 |
| Alabama | 24.2 |
| Indiana | 23.8 |
| Idaho | 23.3 |
| New Mexico | 22.4 |
| Arkansas | 22.3 |
| Kentucky | 22.3 |
| Kansas | 21.0 |
| Washington | 19.6 |
| South Carolina | 19.4 |
| Utah | 19.4 |
| South Dakota | 19.3 |
| Tennessee | 19.2 |
| Ohio | 18.2 |
| Iowa | 17.5 |
| Oregon | 17.5 |
| Nebraska | 17.0 |
| Pennsylvania | 15.7 |
| U.S. Average | 15.7 |

*States not shown are below the national average and consume less than 15,700 BTUs per dollar of gross state product.

Source: American Petroleum Institute, based on data from the Statistical Abstract of the United States.

APPENDIX

TABLE 3

ENERGY OPERATING RATIOS BY SELECTED INDUSTRIES, 1988.

| Industry Groups and Industry | Consumption per Dollar of Value Added (in thousands of BTUs) |
|------------------------------------|---|
| Food and Kindred Products | 7.6 |
| Tobacco Products | 1.4 |
| Textile Mill Products | 10.8 |
| Apparel and Other Textile | 1.3 |
| Lumber and Wood Products | 13.0 |
| Furniture and Fixtures | 3.1 |
| Paper and Allied Products | 36.7 |
| Paper Mills | 64.4 |
| Paperboard Mills | 96.3 |
| Printing and Publishing | 1.3 |
| Chemicals and Allied Products | 22.4 |
| Industrial Inorganic Chemicals | 33.1 |
| Plastics Materials and Resins | 23.8 |
| Industrial Organic Chemicals | 45.7 |
| Nitrogenous Fertilizers | 192.1 |
| Petroleum and Coal Products | 127.0 |
| Petroleum Refining | 143.4 |
| Rubber and Misc. Plastics Products | 5.6 |
| Leather and Leather Products | 3.3 |
| Stone, Clay and Glass Products | 29.5 |
| Cement, Hydraulic | 150.7 |
| Primary Metal Industries | 45.9 |
| Blast Furnaces and Steel Mills | 95.9 |
| Primary Aluminum | 65.3 |
| Fabricated Metal Products | 4.4 |
| Industrial Machinery and Equipment | 2.0 |
| Electronic and Electric Equipment | 2.2 |
| Transportation Equipment | 2.4 |
| Instruments and Related Products | 1.3 |
| Misc. Manufacturing Industries | 2.2 |
| All Manufacturing | 12.1 |

Source: U.S. Department of Energy

PREPARED STATEMENT OF RICHARD L. LAWSON

Mr. Chairman and members of the Committee: I am Richard Lawson, President of the National Coal Association (NCA). NCA is the Washington, D.C. based industry association which represents coal producers and other companies associated with production, domestic distribution, and export of U.S. coal. NCA's member companies account for approximately 70 percent of total U.S. coal production and 80 percent of U.S. coal exports. Our members operate mines in all regions of the country and serve all markets: the utilities, the steel mills and the industrial markets in the United States as well as utilities and steel mills abroad.

Mr. Chairman, despite the fact that several of the provisions contained in the President's economic proposal, including the Btu tax, will impact the coal industry, the National Coal Association, believing that deficit reduction is a paramount national priority, supports the modified Btu tax. We commend the Administration for recognizing the problems of a tax placed directly on energy production and we are

committed to work with the Congress and the Administration for the passage of the Btu tax.

We have now come to the point where the nation must address the need to reduce an ever growing deficit and this must override other concerns. There must be a reduction in spending and if necessary, an increase in revenue. Without question, the decisions that are required to address these serious economic problems are difficult. But to postpone these decisions for another day only invites an even harder set of decisions in the future. The National Coal Association supports the efforts being made by President Clinton to address the serious economic problems facing our country.

First and foremost, government spending must be reduced. But if that alone is insufficient to reduce the deficit, we must find a way to increase revenues without putting an undue burden on any sector of the economy or region of the country. The President, as part of a broad economic stimulus/deficit reduction package, proposed a combination of spending cuts, new spending initiatives and tax increases. Much of the revenue required would be obtained by increasing the income tax rates on upper income individuals and corporations, but a share will be raised by a broad based energy tax in the form of a Btu tax.

In addition to contributing revenue for the overriding objective of deficit reduction, the Administration has outlined certain other objectives that the energy tax is designed to achieve: the promotion of conservation; encouragement of an increase in energy efficiency; and, a reduction in reliance on unstable foreign sources of oil.

To best achieve these objectives, and consistent with our often expressed principle that "there is no bad domestic energy source," the tax should not discriminate against individual energy sources in terms of amount; the tax should be on all sources of energy; and, the incidence of the tax must be borne by the ultimate consumer of energy.

As Secretary Bentsen stated on April 1 when releasing the "Modified Btu Tax Proposal."

"It is our intention that the energy tax be borne fairly and equitably across the country and that the tax promote conservation as well as increased reliance on domestic energy, not foreign oil. If the tax is to effectively promote energy conservation, it must be borne by the ultimate consumer. The Administration is continuing to explore methods of assuring that the tax is in fact passed through to those who use the energy."

The Btu tax proposal as modified meets the original objectives outlined February 17 by the President but, by moving the tax to a point where the consumer is more likely to bear the incidence of the tax, it will achieve these objectives more readily. It continues to encourage conservation, energy efficiency and a reduction in energy imports. It will raise a significant amount of money, a projected \$33 billion annually when fully implemented, to be available for the paramount objective of deficit reduction.

With respect to coal, the actual Btu content would be used to determine the tax due which would average \$5.57 per ton, a significant 26 percent of the average selling price. As modified, the tax on coal would be imposed at the point of receipt at the end user—the utility or the industrial plant—which would be liable for the tax on coal received at their facility and would remit the amount due to the Government. Coal used as a feedstock, including coal used as a feedstock in the production of other energy forms, i.e. synthetic natural gas or beneficiated coal, would be taxed in its altered form at the point of receipt by the end user. Coal used as an industrial feedstock, e.g. to make coke, steel, pharmaceuticals, etc. would not be taxed. A "floor stock tax" would provide for taxation of floor stocks at the end user on July 1, 1994 and at each subsequent point of phase in.

Exports remain exempt from the tax. This is especially important for the coal industry where approximately 10 percent of our output, over 100 million tons, moves into an extremely competitive world market. Even a small increase in price causes the U.S. to lose markets and an increase of the magnitude of the Btu tax would cost the U.S. nearly the entire 100 million tons that are shipped.

More broadly speaking, energy is the engine required for economic growth and, no matter what form taken, taxes on this important sector have a negative effect on economic growth. For this reason, we would suggest that the Btu tax be phased out as soon as the budget deficit reduction objectives are met. In addition we have attached some additional comments which could further enhance the proposal's capability to achieve administration objectives, maintain a level playing field among the energy sources, and minimize negative impact upon the international competitiveness of U.S. exports.

COMMENTS ON THE MODIFIED BTU TAX PROPOSAL

1. There needs to be a clear directive that utilities can pass the tax on immediately to the final consumer, without the necessity of applying for permission from the various state public utility commissions. In some jurisdictions there are moratoria on rate increase, and an additional tax is not likely to be passed on quickly under such circumstances. Without clear direction from the Congress, even in the most responsive jurisdictions, some delay is possible resulting in adverse impacts on utilities. The tax must be borne by the consumer if additional conservation is to be fostered.

2. The modified Btu tax proposal clearly states that coal used in the production of synthetic natural gas is exempt and that the tax is levied instead at the point of collection for gas. Consistent with this intent, the exemption needs to be clarified to indicate that all fuels used as feedstock to produce other fuels are treated in a similar manner. This will be especially important in encouraging the use of technologies that are either under development or just entering the commercial market to use all fuels more efficiently.

3. Consistent with the Administration's proposal on the treatment of industrial feedstocks, metallurgical coal used for making coke and steel should be specifically designated as an exempt feedstock.

4. Taxing energy to produce and transport energy results in a compounding effect upon both industrial and private consumers and the resulting price increases can harm global competitiveness. The modified proposal exempts crude oil or natural gas produced and used on the premises in extraction of energy from the tax. This exemption should logically be clarified and extended to all energy used to produce and transport energy.

5. The tax on coal is imposed "upon fuel delivery." This phrase should be clarified to indicate that the tax attaches at the physical location of use, i.e. at the utility or industrial plant. Depending on contractual arrangements, "Upon fuel delivery" could be interpreted to mean as the coal is loaded at the mine. The clear intent of the proposal is to tax the coal that is actually used for fuel purposes. This clarification would address situations such as rail, barge or truck accidents which result in coal being lost prior to use. Such clarification would also avoid costly litigation in state courts in interpreting the point of tax incidence.

6. A separate tax component of the Administration's package which would adversely impact users of coal and other commodity exports, is the proposed new \$1.00 per gallon barge fuel tax. This proposed tax, which is in addition to the existing barge fuel tax and the proposed energy tax, would increase barge coal rates of 20-25 percent and would result generally in a 4.5-8.5 percent increase in the delivered price of U.S. coal. Just as the export market cannot stand even a portion of the Btu tax, our international competitiveness would be eroded by this sharp increase in barge fuel taxes. Most of the 15 million tons of export coal and the billions of dollars of other American exports shipped on the river system to the Gulf Coast for export would be lost to international competition.

PREPARED STATEMENT OF DENNIS NAGEL

Mr. Chairman and Members of the Committee:

Good morning. I am Dennis Nagel, Chairperson of the Iowa Utilities Board and President of the National Association of Regulatory Utility Commissioners (NARUC), on whose behalf I am testifying here today. The NARUC greatly appreciates the opportunity to present its views on the subject of the President's energy tax proposal.

The NARUC is a quasi-governmental, nonprofit organization founded in 1889. Within its membership are the governmental agencies of the fifty States, the District of Columbia, Puerto Rico and the Virgin Islands engaged in the regulation of carriers and utilities. NARUC's chief objective is to serve the public interest by seeking to improve the quality and effectiveness of regulation.

Introduction

The NARUC has been an active participant in the debate over the Administration's modified BTU tax since shortly after President Clinton announced his original tax proposal in February. Following this, the NARUC Executive Committee in March took the unprecedented step of rescinding our 1990 position opposing broad-based energy taxes and adopting a position of neutrality on the issue for now. This was done in order to signal the Administration and the Congress that the NARUC would have an open mind about the issue of energy taxes. While we remain neutral on the issue of an energy tax, our resolution states six items we believe should be addressed in the design of any broad-based energy tax, including the President's modified BTU tax. A copy of our resolution is attached (see Attachment #1).

As the Committee is well aware, the Treasury Department on April 1st announced revisions to the original modified BTU tax proposal. In my statement today, I would like to comment first on the Treasury Department proposal to ensure passthrough of the BTU tax to utility ratepayers. I then would like to comment on each of the other items of our resolution and how they relate to the President's modified BTU tax proposal.

Representatives of the NARUC have met with Treasury Department officials and made them aware of our concerns about the passthrough proposal. We greatly appreciate their willingness to listen to our concerns, and look forward to working with them further as their proposal moves into the legislative stage. I also want to express the willingness of the NARUC to work with this committee as it considers the Administration's energy tax proposal and prepares to take action on it.

I also want to be clear about where we stand on the passthrough issue: the NARUC supports one of the key objectives of the modified BTU tax, which is to send price signals to energy consumers to conserve energy. We are willing to work with the Administration, the Congress and other interested parties in seeing that this objective is achieved. At the same time, the NARUC is committed to its twin principles of seeing that Federal pre-emption of State regulation is an action of absolute last resort and should be done only when fully justified, and that State commissions, because of their proximity to the people they regulate, are best able to determine the justness and reasonableness of utility rates.

Normalization Should Not Be Used to Mandate Passthrough

The Treasury Department's April 1 proposal on the passthrough issue would deny certain tax benefits to utilities for periods during which the energy tax is not completely passed through to end users. These benefits involve special treatment accorded to investor-owned utilities' use of accelerated depreciated and investment tax credits. Under the tax code, these benefits can be "normalized" for book purposes, meaning that the utility may treat these benefits differently for rate purposes than for Federal tax purposes.

While the NARUC has consistently opposed the "normalization" of these benefits for rate purposes, I do not believe that a State commission would deny Federal tax benefits to any utility by preventing the passthrough of the BTU tax. A commission that did so would run the risk of not only putting the utility it regulates at a competitive disadvantage vis-a-vis other utilities who are granted passthrough, but also putting that utility in a precarious financial condition that could affect its ability to serve its customers. State commissions are charged with the responsibility of seeing that the utilities they regulate stay in business.

Withholding the benefits of normalization from a utility for the time period that the BTU tax is not passed through would unnecessarily extend the reach of the normalization provisions into another area of State ratemaking authority. It also runs counter to the original congressional intent of normalization, which was to slow the flow-through of utility tax benefits to ratepayers. For these reasons, the NARUC believes such a proposal is ill-conceived and should be rejected.

Passthrough Mechanisms Exist

I would submit that there already exists a time-tested and effective means of passthrough: State commission rate-setting mechanisms.

Most State commissions have a mechanism for dealing with fuel cost increases that would occur as a result of the modified BTU tax. These mechanisms are generally known as energy cost adjustments and are commonly referred to as fuel adjustment clauses (FACs) in the electric utility industry and purchased gas adjustments (PGAs) in the gas utility industry. The tables accompanying my testimony indicate that three-quarters of the States have FACs in place for the electric utilities they regulate and 47 use PGAs for the gas utilities they regulate (see Attachment #2.) These adjustments are made to utility rates periodically: monthly, semi-annually, annually or on some other basis depending on each commission's rules.

In States without these mechanisms or in the case when the BTU tax is imposed directly on the utility (i.e. for hydro- and nuclear-generated electricity), a utility may file for a rate increase. These increases typically go into effect in short order, subject to suspension by the State commission. In fact, assuming that the tax will not take effect until July 1994, as proposed by the Treasury Department, utilities would have sufficient time to file for such an increase. Both rate mechanisms -- energy cost adjustments and rate filings -- provide ample opportunities for utilities to recover the increased costs due to a Federal energy tax.

There also is no evidence to support the claim that a State commission would withhold any portion of a Federal tax paid by a utility. In fact, we can find no case of a State commission taking such action against a utility. State commissions are obliged to include all reasonable costs of providing utility service in rates, and bona fide taxes imposed by the Federal government have always been viewed as recoverable costs.

Incentives for Utility Efficiency Gains, Optimal Fuel Use

The NARUC believes that such any BTU tax should be designed to encourage energy efficiency and optimal use of fuels. We do not believe there is sufficient evidence to prove that energy efficiency would be substantially improved if there is a mandatory requirement that utility ratepayers bear the full cost of the BTU tax. As we stated above, most States have the ability to pass through the increased cost of the tax through FACs and PGAs. In addition, the direct tax on utilities will be considered in rate proceedings. However, guaranteeing a 100 percent passthrough does not, in our opinion, guarantee substantially more energy savings or energy efficiency improvements. It actually removes incentives for utilities to make their energy production, transmission and distribution operations more efficient. These efforts encompass the optimum use of fuels used in the generation of electricity.

Congress in passing the Energy Policy Act of 1992 expressly required State commissions to consider regulatory incentives that would allow electric utilities to improve their supply-side efficiencies (see Section 111 of P.L. 102-486). The NARUC supported enactment of this provision. Ensuring that the tax is borne only by the entities on the demand-side of the utility meter runs counter to this policy. Therefore, we believe that any energy tax should be designed to encourage efficiency in the supply as well as the consumption of energy.

Now I would like to address the other points of our resolution and how they relate to the latest version of the modified BTU tax proposal.

Geographic Equity and Fairly Spread Over All Fuels

The resolution adopted by NARUC calls for any broad-based energy tax to be applied in a manner that assures geographic equity in tax burdens and to assure that the tax burdens will be spread fairly over all fuel sources, including hydro. This part of our resolution deals with the issue of making any energy tax as fair as possible to all those who will be affected by it. By applying the tax to all fuel sources for electric generation, we believe that some measure of geographic equity can be achieved with respect to the potential impact on utilities and their customers in different regions of the country. In addition, we believe that the tax should be applied to all fuel sources so that it is not only the utility fuel sector that is affected. The President's BTU tax proposal appears to meet this objective by including fuels used for electric utility generation as well as fuels used in other sectors of the economy. However, we are concerned by the increased number of exemptions that were included in the April 1 revision of the proposal. If all of these exemptions are allowed and are expanded even further, we believe that the goal of regional equity and fairness may be lost.

Consistent With Transition to Cleaner Technologies/Renewable Resources

The NARUC has advocated the development of renewable energy technologies. The association was supportive of provisions under the Energy Policy Act to provide investment and production tax incentives for renewable energy technologies, which this Committee worked on in the last Congress. We did so based on evidence that renewable energy technologies lag behind conventional energy technologies in their acceptance by utilities and other businesses as sources capable of producing clean, cost-effective electric power.

The April 1 Treasury Department announcement suggested an expanded list of renewable energy sources that would qualify for exemptions from the modified BTU tax. We are concerned that this expanded list includes technologies that have been shown to have significant environmental impacts i.e. municipal solid waste and tires burned as fuel. Therefore, we would urge that if the goal of the BTU tax is to promote cleaner, renewable technologies, a reconsideration of the list of exempted renewables should be made.

Contribute to U.S. Productivity, Technology Export Opportunities and Competitiveness

As our resolution states, the design of any broad-based energy tax must contribute toward making the United States more productive, and encourage greater export opportunities and competitiveness. All of these objectives can in some measure be accomplished through increased energy efficiency. The NARUC believes that energy efficiency provides real benefits for the Nation. By making our country's industries more energy efficient, we enhance our ability to compete in world markets. In addition, the tax may spur development of clean energy technologies in the U.S. that have great export potential. The effect of energy taxes on the energy component of the products we produce and export, however, should not be overlooked. These additional costs must be weighed against the incentive an energy tax would create to cut the costs of producing domestic goods and services.

Offset Impacts on Low-Income Customers

The fifth point of our resolution addresses the issue of impacts resulting from a broad-based energy tax on low-income utility customers. The NARUC believes that any energy tax proposal must mitigate the regressive impacts on low-income utility ratepayers. We are aware that the President's proposal would include offsets such as an expanded earned income credit and increased funding for the Low-Income Home Energy Assistance Program (LIHEAP) and the Department of Energy's Low-Income Weatherization Assistance Program (WAP). Our resolution also supports efforts aimed at providing "education and targeted energy efficiency" for low-income ratepayers to help them reduce the overall use of energy. The NARUC has consistently supported funding for these programs as the best insurance that low-income ratepayers are able to meet their energy bills. Yet in recent years the effectiveness of these programs has been diminished by reduced Federal funds. We strongly urge Congress to fully fund these programs to restore their effectiveness in reaching the people who most need them as well as making up for the increased energy costs that would result from the imposition of an broad-based energy tax.

Investment Tax Credits

Unrelated to the issue I have discussed above, but a part of the President's overall tax package, is the revival of the investment tax credit, which was repealed by the Tax Reform Act of 1986. Revival of the ITC would mean that utilities would be allowed to claim credit against current and future income for their investments in qualifying assets. The current tax code requires a "normalization" treatment of these credits, which would mean that the benefits are passed on to ratepayers over the lifetime of the utility's asset. The NARUC opposes mandatory normalization treatment of ITC. If normalization is required, we would advocate that current tax law be changed to apply economic normalization to the ITC, allowing more of the benefits of ITC to be passed on to ratepayers. Past treatment of this benefit created a bias toward new construction that put shareholder interests at odds with consumer interests and contributed to expensive power plant construction decisions. In an era when the benefits of conservation are clearer than ever, it would be a serious mistake to adopt a tax policy that artificially favors capital intensive approaches to energy supply when the consumer is better served by energy efficiency.

Conclusion

The modified BTU tax is a serious matter for State commissioners. It will directly impact the ratepayers of the electric and gas utilities we regulate. This causes all of us in the regulatory community great concern. As our resolution states, if there is to be a broad-based energy tax, there are certain components that must be part of the package. There are several difficult issues concerning the implementation of any broad-based energy tax. I have discussed some of them with you today, and pledge that the NARUC is willing to work with your Committee, the Congress and the Administration in determining what proposal is the best for our country.

ATTACHMENT #1

Resolution on the Design of Energy Taxes

WHEREAS, The Administration and members of Congress will be considering adopting a broad-based energy tax as part of a comprehensive package of actions to address the Federal deficit and long-term economic growth; and

WHEREAS, State regulated utility ratepayers and shareholders will be affected by any such tax through its impacts on costs, energy efficiency, and utility resource decisions; and

WHEREAS, By covering a portion of the economic impact not currently reflected in the price of fuels, a properly designed tax policy which encourages energy efficiency may have long-term positive economic benefits by increasing U.S. productivity and competitiveness as well as avoiding or mitigating detrimental environmental impacts of resource decisions; and

WHEREAS, The National Association of Regulatory Utility Commissioners (NARUC) previously adopted a resolution opposing a general broad-based energy tax at a time when such taxes were being considered solely as a method to reduce the deficit and not as part of any comprehensive economic plan; and now, therefore, be it

RESOLVED, That the Executive Committee of the National Association of Regulatory Utility Commissioners (NARUC), convened at its Winter Meeting in Washington, D.C., hereby rescinds the previous resolution on energy taxes adopted July 26, 1990; and be it further

RESOLVED, While the NARUC does not support or oppose a broad-based energy tax at this time, the NARUC Executive Committee believes that any broad-based energy tax as part of a comprehensive package of actions to reduce the Federal deficit and spur long-term economic growth should:

- (1) be applied in a manner that assures geographic equity in tax burdens and assures that the tax burdens will be fairly spread over all fuels, including hydro;
- (2) be designed to encourage energy efficiency and the optimal use of fuels;
- (3) be consistent with the transition to use of cleaner technologies and renewable resources;
- (4) contribute to U.S. productivity, technology export opportunities and competitiveness;
- (5) be accompanied by programs that offset impacts on low-income customers, including education and targeted energy efficiency programs that help reduce the use of energy; and
- (6) not restrict State regulatory commissions' discretion in the treatment of costs associated with the imposition of energy taxes.

Sponsored by the Committees on Electricity and Energy Conservation
Adopted March 3, 1993

ATTACHMENT #2

SECTION 4

ENERGY COST ADJUSTMENT CLAUSES - ELECTRIC AND GAS

Table 24 displays electric utility use of energy cost adjustment clauses, whether a hearing is required prior to recovering costs, whether periodic filings are required, what types of costs may be recovered via adjustment clause and whether the agency uses a true-up procedure for over- or under-recoveries.

Table 25 displays the same information for gas utilities.

TABLE 24 - REGULATION OF ELECTRIC UTILITY ENERGY COST ADJUSTMENT CLAUSES

| FAC=Fuel Adjustment Clause AGENCY • | Has Authority to Establish Energy Cost Adjustment Procedure? | The Agency | | | | | | | Uses a True-up Procedure for Over- or Under-Recoveries |
|---|--|---|--|----------------------------------|---|-------------------------|---------------|--|--|
| | | Allows Use of FAC to Recover Cost Changes | Requires FAC Hearing Prior to Cost Recovery? | Requires Periodic FAC Filing(s)? | Allows Changes in these Cost Components to be Recovered by Way of Fuel Adjustment Clause (FAC)? | | | | |
| | | | | | Fuel Costs | Purchased Energy Charge | Demand Charge | Other | |
| FERC | YES | YES | NO | NO | YES | YES | NO | \$35.22(e) R&D | YES |
| ALABAMA PSC | YES | YES | NO | 1 | YES | YES | NO | Taxes not assessed uniformly statewide (ie, municipal tax) | YES |
| ALASKA PUC | YES | YES | NO | Q, O | YES | YES | YES | Interest expense. | YES |
| ARIZONA CC | NO | 7/ | NO 1/ | Rate Case | M | YES | YES | NO 1/ | |
| ARKANSAS PSC | YES | YES | NO | M | YES | YES | YES | Municipal franchise tax. Co-ops - cost of debt adjustment 9/ | YES |
| CALIFORNIA PUC | YES | YES | YES and Annually | A | YES | YES | YES | Increased franchise fees. Uncollectibles associated with revenue change. | YES |
| COLORADO PUC | YES | YES | NO Annual | M, A | YES | YES | YES | Interchange power. | YES |
| CONNECTICUT DPUC | YES | YES | YES and Annually | M | YES | YES | NO | Savings shares to FAC & PGA revenues, generation utilization. | YES |
| DELAWARE PSC | YES | YES | YES | A | YES | YES | YES | | YES |
| DC PSC | YES | YES | NO | M | YES | YES | YES | | YES |
| FLORIDA PSC | YES | NO | YES & S | M, S | YES | YES | YES | Conservation costs. | YES |
| GEORGIA PSC | NO | NO | YES | 1 | YES | YES | NO | Transportation. | YES |
| HAWAII PUC | YES | YES | In Rate Case | 1 | YES | YES | NO | Public service company tax. Public utility fee. Franchise tax on gross revenues. | YES |
| IDAHO PUC | YES | NO 2/ | YES 2/ | | | | | | |
| ILLINOIS CC | YES | YES | NO, Annually | M | YES | YES | YES | Ad Valorem taxes on large use rates that are priced close to costs. Gross revenue taxes as effected by cost increase collected via FAC. | YES |
| INDIANA URC | YES | YES | Q | O | YES | YES | NO | Steam/Hydro generation | YES |
| IOWA UB | YES | YES | NO | 1 | YES | YES | YES | | YES |
| KANSAS SCC 15/ | YES | YES | YES for purchased power | M | YES | YES | YES | Costs included in FERC Acct 151, less refunds Acct 555 - co-ops. Acct 555 less demand, capacity & fixed charges for IOUs. Limestone for scrubbers, other. KCC 106.850-U. | YES |
| KENTUCKY PSC | YES | YES | NO, S & B | M | YES | YES | NO | FERC Acct 151-transp. | YES |
| LOUISIANA PSC | YES | YES | YES & M | M | YES | YES | NO | Transportation/taxes | YES |
| MAINE PUC | YES | YES | NO, Annually | A, M | YES | YES | YES | Conservation cost, indirect fuel cost. | YES |
| MARYLAND PSC | YES | YES | YES & S | 1 | YES | YES | YES | | YES |
| MASSACHUSETTS DPUC | NO | YES | YES & Q | Q | YES | YES | YES | | YES |
| MICHIGAN PSC | NO | YES | YES and Annually | A | YES | YES | YES | O&M expenses other than fuel, electric production maintenance costs. | YES |
| MINNESOTA PUC | YES | 3/ | YES | M | YES | YES | NO | | |
| MISSISSIPPI PSC | YES | YES | YES | NO | YES | YES | NO | Transportation/taxes | YES |
| MISSOURI PSC | NO | 10/ | NO | | | | | | |
| MONTANA PSC | NO | NO | | | | | | | |
| NEVADA PSC | YES | NO | YES, A | A | YES | YES | YES | Capacity costs | YES |

NOTE See also Table 67 for Audits performed in conjunction with Fuel Adjustment Clause.

A=Annually
S=Semi-Annually
Q=Quarterly
M=Monthly
O=Other Regular Timeframe
1=Irregular Interval or As Necessary

Fuel Adjustment Clause (FAC) is the term used generically to refer to energy cost adjustment procedures for electric utilities.

TABLE 24 - REGULATION OF ELECTRIC UTILITY ENERGY COST ADJUSTMENT CLAUSES
(Continued)

| FAC=Fuel Adjustment Clause | AGENCY | Has Authority to Establish Energy Cost Adjustment Procedure? | The Agency | | | | | | | Uses a True-up Procedure for Over- or Under-Recoveries |
|----------------------------|--------|--|---|--|----------------------------------|---|-----------------|---------------|---|--|
| | | | Allows Use of FAC to Recover Cost Changes | Requires FAC Hearing Prior to Cost Recovery? | Requires Periodic FAC Filing(s)? | Allows Changes in these Cost Components to be Recovered by Way of Fuel Adjustment Clause (FAC)? | | | | |
| | | | | | | Fuel Costs | Purchased Power | Demand Charge | Other | |
| | | | YES | SEE KEY | BELOW | YES | YES | NO | | YES |
| NEW HAMPSHIRE PUC | | YES | YES | YES & M, S | M, S | YES | YES | YES | Revenue taxes and energy losses. | YES |
| NEW JERSEY BRC | | YES | YES | YES | A | YES | YES | YES | | |
| NEW MEXICO PSC | | YES | YES | NO | M | | YES | YES | | YES |
| NEW YORK PSC | | YES 3/ | YES 5/ | NO, Hearings held min 4 yrs | M | YES | YES | YES | Changes in city/village revenue tax surcharges. | NO |
| NORTH CAROLINA UC | | NO | YES | YES and annually | A | YES | YES | NO | Energy portion of interchanged power. | YES |
| NORTH DAKOTA PSC | | YES | YES | min 4 yrs | M | YES | YES | NO | | |
| OHIO PUC | | NO | YES 6/ | NO, semi-annually | M, S, A | YES | NO | NO | System loss, Ohio civil R&D costs. | YES |
| OKLAHOMA CC | | YES | YES | NO, semi-annually | M | YES | YES | YES | All items charged to fuel in FERC accounts | YES |
| OREGON PUC | | YES | NO | | | | | | | |
| PENNSYLVANIA PUC | | YES | YES | NO | Q, A | YES | YES | NO | Taxes on corp. stock, net income, gross receipts, realty. | YES |
| RHODE ISLAND PUC | | YES | YES | YES | Q, O | | YES | NO | | YES |
| SOUTH CAROLINA PSC | | YES | YES 8/ | NO, S | S | YES | YES | NO | Interchange power. | YES |
| SOUTH DAKOTA PUC | | YES | YES | NO | | YES | YES | NO | | YES |
| TENNESSEE PSC | | YES | YES | NO | M | YES | YES | YES | | |
| TEXAS PUC | | NO | NO | | | | | | | |
| UTAH PSC | | NO | YES | YES, I, S | M | YES | YES | NO | Of energy, geothermal | YES |
| VERMONT PSB 11/ | | NO | NO | | | | | | | |
| VIRGINIA SCC | | NO | NO | YES | I | YES | YES | YES | Uses Projected Fuel Factor. | YES |
| WASHINGTON UTC | | YES 14/ | NO | | | | | | | |
| WEST VIRGINIA PSC | | NO | YES | YES, A | A | YES | YES | YES | Off system sales. | YES |
| WISCONSIN PSC | | YES | NO 4/ | NO, A | A | YES | YES | NO | Transportation. | |
| WYOMING PSC | | YES | NO | 12/ | | | | | | |
| VIRGIN ISLANDS PSC | | YES | YES | YES | | | | | | |
| ALBERTA PUB | | YES | YES | YES | M | YES | YES | YES | | |
| NOVA SCOTIA PUB 16/ | | | NO | | | | | | Fuel cost built into rates. | |

NOTE See also Table 67 for Audits performed in conjunction with Fuel Adjustment Clause.

A=Annually
S=Semi-Annually
Q=Quarterly
M=Monthly
O=Other Regular Timeframe
I=Irregular Interval or As Necessary

Fuel Adjustment Clause (FAC) is the term used generically to refer to energy cost adjustment procedures for electric utilities.

** For greater detail on PGA and FAC, consult "Current PGA and FAC Practices: Implications for Rate-making in Competitive Markets", November 1991, National Regulatory Research Institute-NRRI 91-13.

FOOTNOTES - TABLE 24

- 1/ Automatic fuel adjustment clause was eliminated in November 1978 for investor-owned electric utilities.
- 2/ One electric utility has power cost adjustment clause to reflect changes in hydro-generation due to abnormal stream flows; subject to evidentiary proceeding.
- 3/ Commission permits utilities to file rate schedules containing provisions for automatic adjustment of charges.
- 4/ Effective with their first rate case held after July 2, 1983, investor-owned electric utilities which generate more than half of their energy requirements may not have an automatic adjustment clause.
- 5/ Utilities required to justify continuation of fuel adjustment clauses on an individual basis.
- 6/ Automatic fuel adjustment clause was eliminated as of 1/01/79 for investor-owned electric utilities. Fuel cost rate changes every 6 months, after hearing and commission order. Company may include demand cost or purchased economic power.
- 7/ In 1989 Commission eliminated adjustment clause for two large electric utilities.
- 8/ Adjusted on a semi-annual basis.
- 9/ "Other" - other areas of automatic adjustment clauses - not included in energy cost adjustment, but as a separate line item. Purchased power for water/sewer utilities.
- 10/ In Missouri the fuel adjustment was ruled unconstitutional for electric service on October 1, 1979. See: Utility Consumers Council of Missouri v. Public Service Commission, 562S.W.2d688.
- 11/ Abolished by Vermont Supreme Court Ruling in Docket No. 4496/4504, 1984.
- 12/ Opportunity for Hearing (N.C. ce).
- 13/ Commission requires each related gas and electric utility to file its cost of fuel adjustment calculations for review and approval prior to implementation. In 1987 changed to annual review and adjustment.
- 14/ Energy cost adjustment clause previously authorized to one IOU electric was eliminated January 1990 and replaced in April 1991 with a limited adjustment clause.
- 15/ Eliminated April 1992 as a condition of approval of the merger of KPL and KG&E.
- 16/ Commission did not respond to request for update information; this data may not be current.

TABLE 25 - REGULATION OF GAS UTILITY ENERGY COST ADJUSTMENT CLAUSES

| PGA=Purchased Gas Adjustment Clause | Has Authority to Establish Energy Cost Adjustment Procedure? | The Agency | | | | | | | Uses a True-up Procedure for Over- or Under-Recoveries | |
|-------------------------------------|--|---|--|---------|------|-----------------|--------------|---|--|-----|
| AGENCY ** | | Allows Use of PGA to Recover Cost Changes | Requires PGA Hearing Prior to Cost Recovery? | SEE KEY | | Commodity Costs | Demand Costs | Transport Charge | Other | |
| | | | | BELOW | O, A | | | | | |
| FERC | YES | YES | NO | O, A | YES | YES | YES | \$35.22(e) B&D | | YES |
| ALABAMA PSC | YES | YES | NO | A, I | YES | YES | YES | TOP, GIC, storage, competitive fuel clause adjustments, | | YES |
| ALASKA PUC | YES | YES | NO | O | YES | | | | | YES |
| ARIZONA CC | NO | YES 3/ | | M | YES | YES | YES 1/ | TOP liability. | | |
| ARKANSAS PSC | YES | YES | NO | M | YES | YES | YES | Municipal franchise tax. Co-ops - cost of debt adjustment 4/ | | YES |
| CALIFORNIA PUC | YES | YES | YES and Annually | A | YES | YES | YES | TOP, GIC, storage, administrative costs associated with fuel procurement. | | YES |
| COLORADO PUC | YES | YES | YES & A | A | YES | YES | | | | YES |
| CONNECTICUT DPUC | YES | YES | YES and monthly, quarterly | M | YES | YES | YES | Savings shares to PGA revenues, GIC, storage, refunds, etc. | | YES |
| DELAWARE PSC | YES | YES | YES & S/A | S, A | YES | YES | YES | TOP, GIC, Storage. | | YES |
| DC PSC | YES | YES | NO | M | YES | YES | YES | TOP, GIC, Storage. | | YES |
| FLORIDA PSC | YES | YES | YES & S | S | YES | YES | YES | TOP, GIC, Storage. | | YES |
| GEORGIA PSC | YES | YES | NO | I | YES | YES | YES | TOP, GIC, Storage. | | YES |
| HAWAII PUC 11/ | YES | | NO | I | | | | Public service company tax. Public utility fee. franchise tax on gross revenues. | | |
| IDAHO PUC | YES | YES | YES | A, I | YES | YES | YES | TOP, GIC, Storage. | | YES |
| ILLINOIS CC | YES | YES | NO, Annually | M, A | YES | YES | YES | Ad Valorem taxes on large use rates that are priced close to costs. Gross revenue taxes as affected by cost increase collected via PGA. TOP, GIC, Storage. | | YES |
| INDIANA URC | YES | YES | YES | O, S | YES | YES | YES | TOP, GIC, Storage. | | YES |
| IOWA UB | YES | YES | NO | I | YES | YES | YES | TOP, GIC, Storage. | | YES |
| KANSAS SCC | YES | YES | NO | A, M | YES | YES | | Costs included in FERC Acct 151, less refunds Acct 555 - co-ops. Acct 555 less demand, capacity & fixed charges for IOUs. Limestone for scrubbers, other. KCC 106,850-U. Storage. | | YES |
| KENTUCKY PSC | YES | YES | NO, S & B | O, S | YES | YES | YES | TOP liability. | | YES |
| LOUISIANA PSC | YES | YES | YES, A | M | YES | YES | YES | TOP, taxes. | | YES |
| MAINE PUC | YES | YES | NO, Annually | S | YES | YES | YES | Conservation cost, indirect fuel cost. TOP, Storage. | | YES |
| MARYLAND PSC | YES | YES | NO, S | M | YES | YES | YES | TOP, GIC, Storage. | | YES |
| MASSACHUSETTS DPUC | YES | YES | | S | YES | YES | YES | TOP, GIC, Storage, interest. | | YES |
| MICHIGAN PSC | NO 10/ | NO | | | | | | | | |
| MINNESOTA PUC | YES 1/ | YES | NO | O, I | YES | YES | YES | TOP, Storage. | | YES |
| MISSISSIPPI PSC | YES | YES | NO | NO | YES | YES | YES | TOP, GIC, Storage. | | YES |
| MISSOURI PSC | YES | YES | NO | I | YES | YES | YES | TOP, GIC, Storage. | | YES |
| MONTANA PSC | NO | YES | YES | A, B | YES | YES | YES | TOP, Storage. | | YES |

NOTE See also Table 67 for Audits performed in conjunction with Purchased Gas Adjustment Clause.

A=Annually
S=Semi-Annually
Q=Quarterly
M=Monthly
O=Other Regular Time
I=Irregular Interval
+ or As Necessary
B=Biannually

Purchased Gas Adjustment Clause (PGA) is the term used generically to refer to energy cost adjustment procedures for gas utilities (LDCs).

TABLE 25 - REGULATION OF GAS UTILITY ENERGY COST ADJUSTMENT CLAUSES
(Continued)

| PGA=Purchased Gas Adjustment Clause AGENCY ** | Has Authority to Establish Energy Cost Adjustment Procedure? | The Agency | | | | | | | Uses a True-up Procedure for Over- or Under-Recoveries |
|---|--|---|--|----------------------------------|--|--------------|------------------|---|--|
| | | Allows Use of PGA to Recover Cost Changes | Requires PGA Hearing Prior to Cost Recovery? | Requires Periodic PGA Filing(s)? | Allows Changes in these Cost Components to be Recovered by Way of Purchased Gas Adjustment Clause (PGA)? | | | | |
| | | | SEE KEY BELOW | | Commodity Costs | Demand Costs | Transport Charge | Other | |
| NEVADA PSC | YES | YES | YES, A | A | YES | YES | YES | Capacity costs | |
| NEW HAMPSHIRE PUC | YES | YES | YES & S | B, S | YES | YES | YES | TOP, Storage | YES |
| NEW JERSEY BRC | YES | YES | YES & A | A | YES | YES | YES | Revenue taxes, energy losses, TOP, Storage. | YES |
| NEW MEXICO PSC | YES | YES | NO, B | M | YES | | YES | Market based GIC. | YES |
| NEW YORK PSC | YES 1/ | YES | NO | M | YES | YES | YES | TOP, GIC, Storage, changes in local tax surcharges. | YES |
| NORTH CAROLINA UC | NO | YES | NO | S | YES | YES | YES | TOP, market based GIC and Storage. | YES |
| NORTH DAKOTA PSC | YES | YES | NO | NO | YES | YES | YES | | YES |
| OHIO PUC | YES 2/ | YES | YES | Q | YES | YES | YES | TOP, GIC, Storage, propane. | YES |
| OKLAHOMA CC | YES | YES | NO, semi-annually | M | YES | YES | YES | All charged to gas in FERC accts., TOP. | YES |
| OREGON PUC | YES | YES 6/ | NO, S, A | A | YES | YES | YES | Storage, interest. | YES |
| PENNSYLVANIA PUC | YES | YES | NO, annually | I | YES | YES | YES | Taxes on corp. stock, net income, gross receipts, realty, GIC, Storage. | YES |
| RHODE ISLAND PUC | YES 11/ | YES | YES & A | A | YES | YES | YES | TOP, GIC, Storage. | YES |
| SOUTH CAROLINA PSC | YES | YES | NO, S | M, S | YES | YES | YES | TOP, GIC, Storage. | YES |
| SOUTH DAKOTA PUC | YES 5/ | YES | NO | NO | YES | YES | YES | TOP, GIC, Storage. | YES |
| TENNESSEE PSC | YES | YES | NO | J | YES | YES | YES | TOP, GIC, Storage. | YES |
| TEXAS RC | 11/ | YES | NO | M | | | | | |
| UTAH PSC | NO | YES | YES, I, S | S, A | YES | YES | YES | TOP, gathering. | YES |
| VERMONT PSB | 7/ | NO | | | | | | | |
| VIRGINIA SCC | YES | YES 3/ | YES | Q | YES | YES | YES | TOP, GIC, Storage. | YES |
| WASHINGTON UTC | YES | YES | YES, A | NO | YES | YES | YES | TOP, deficiency based GIC, Storage. | YES |
| WEST VIRGINIA PSC | YES | YES | YES, S, A | A | YES | YES | YES | TOP liability. | YES |
| WISCONSIN PSC | YES | YES | NO, A | A | YES | YES | YES | TOP, deficiency based GIC, Storage. | YES |
| WYOMING PSC | YES 9/ | YES | | 8/ A, Q | YES | YES | YES | TOP, GIC, Storage. | YES |
| VIRGIN ISLANDS PSC | NO | NO | | | | | | | |
| ALBERTA PUB | NO | YES | YES | M | YES | YES | YES | | |
| NOVA SCOTIA PUB | YES | NO | | | | | | | |
| 11/ | | | | | | | | | |
| QUEBEC NGB | YES | YES | NO | | | | | | |

NOTE See also Table 67 for Audits performed in conjunction with Purchased Gas Adjustment Clause.

A=Annually
S=Semi-Annually
Q=Quarterly
M=Monthly
O=Other Regular Time
I=Irregular Interval or As Necessary
B=Biannually

Purchased Gas Adjustment Clause (PGA) is the term used generically to refer to energy cost adjustment procedures for gas utilities (LDCs).

** For greater detail on PGA and FAC, consult "Current PGA and FAC Practices: Implications for Ratemaking in Competitive Markets", November 1991, National Regulatory Research Institute-NRRI 91-13.

- 1/ Commission permits utilities to file rate schedules containing provisions for automatic adjustment of charges.
- 2/ Automatic fuel adjustment clause was eliminated as of 1/01/79 for investor-owned electric utilities. Fuel cost rate changes every 6 months, after hearing and commission order. Company may include demand cost or purchased economic power.
- 3/ Subject to Commission approval.
- 4/ "Other" - other areas of automatic adjustment clauses - not included in energy cost adjustment, but as a separate line item. Purchased power for water/sewer utilities.
- 5/ Required by Statute.
- 6/ Purchased gas adjusted on a six-month or twelve-month basis - no automatic adjustment.
- 7/ PGA abolished in 1985.
- 8/ Opportunity for Hearing (Notice).
- 9/ Commission requires each regulated gas and electric utility to file its cost of fuel adjustment calculations for review and approval prior to implementation. In 1987 changed to annual review and adjustment.
- 10/ Abolished in 1982.
- 11/ Commission did not respond to request for update information; this data may not be current.

PREPARED STATEMENT OF SENATOR ROCKEFELLER

I applaud the Administration and the many in industry who have been working in recent weeks to refine the Btu tax proposal to ensure that it is as fair and workable as possible. That has been my approach, and I have appreciated the cooperation of all those involved.

When we deal with a comprehensive economic package, most of us can find one or another part of the package that we would not have included or would have done differently. But for each Member of Congress to insist on every detail amounts to insisting on doing nothing. That, of course, is unacceptable.

Although it is important to examine closely each piece of the economic package, including the energy tax, we must not forget the bigger picture.

The President has called on Congress to grapple with the fundamental problems of our economy. The task is to stimulate the economy and invest in the future, but at the same time reduce the deficit.

The difficult steps that must be taken to do these things are being taken for a reason. The reason is that continued failure to reduce the deficit and continued neglect of investment in economic growth will destroy our economic future.

The mistakes of the last decade have left us with narrowed options. But I am encouraged by the cooperation that has emerged in working on the energy tax proposals. I am encouraged to believe that there is a growing resolve that the tough steps must be taken for the larger, long term good. I look forward to continuing to work with the Administration and all concerned to ensure that the President's program is enacted into law.

 PREPARED STATEMENT OF ELLEN S. ROY

I. THE NATIONAL INDEPENDENT ENERGY PRODUCERS

Mr. Chairman, my name is Ellen Roy. I am Vice President for Business Development for Intercontinental Energy Corporation and the Chairperson of the Energy Tax Task Force of the National Independent Energy Producers (NIEP). We are pleased to submit this testimony on proposals for a broad-based energy tax as part of the President's deficit reduction package. NIEP is an association of companies that generate electricity for sale to utilities and develop cogeneration projects for a variety of users. NIEP membership is comprised of both publicly-traded and privately-held corporations which represent a broad spectrum of fossil fuel-fired and renewable technologies, including hydro, biomass, pumped storage, geothermal, wood, waste coal and other fuels, as well as oil, gas and coal-fired generation and wholesale generation facilities. Our members sell power at wholesale to utilities on the basis of long-term contracts. We do not have captive ratepayers and do not build rate-based, cost-of-service, powerplants.

NIEP is committed to increasing competition in electric power generation markets. Independent energy has grown out of the entrepreneurial and competitive climate fostered by the Public Utility Regulatory Policies Act of 1978 (PURPA). Competition brings efficiently priced power to the nation's consumers.

Since this 1978 legislation opened the door for competitive power, independent electric producers have expanded non-utility capacity to more than 43,000 megawatts of capacity—equivalent to over 40 large power plants. In addition, this new industry has supplied over 50 percent of all new electric capacity since 1989. This industry relies on state-of-the-art, highly fuel efficient and clean power production technologies. To date, more than \$40 billion has been invested in the independent power industry, producing approximately \$10 billion in power sales revenue annually.

II. THE IMPACT OF THE PROPOSED ENERGY TAX ON INDEPENDENT ELECTRICITY PRODUCERS

Independent power producers (IPPs) are concerned that the energy tax, as originally proposed by the Administration in February, may unfairly disadvantage the cleanest, most efficient, and most competitive sector of the electric generating industry. The Administration's modified proposal released early this month takes significant steps in the right direction; more, however, can be done. Unlike regulated electric utilities which can, in most cases, pass costs on to captive ratepayers, many electric generators, such as independent power producers and utilities who engage in long-term wholesale electricity sales, do so under contracts that do not permit the seller to pass through increases in taxes to the ultimate consumer. Under the Administration's proposed upstream energy tax, these contract suppliers may have to

absorb all or some significant portion of the tax, jeopardizing their financing and the economic viability of their plants. Equally important is the effect which this tax design would have on competition in electric power markets. Wholesale generators of electricity, such as independent power producers, compete with utility cost-of-service plants for the right to build new electric capacity. If independent power producers with long-term contracts are placed at a disadvantage relative to their utility competitors by virtue of the independents' inability to pass through the tax to the ultimate consumer, competition will be tilted in favor of utilities. Consumers may then be denied some of the benefits of competition in electric power markets.¹

The contracts between wholesale electric generators and their utility customers often have terms of 20 years or longer, cover both fixed costs (capital payments) and variable costs (energy and operations and maintenance expenses), are quite complex and vary significantly throughout the country. In assessing these contracts, an important distinction between "pass-through" and "recovery" of taxes must be made. A contract which permits an IPP to bill and collect from utilities on a dollar-for-dollar basis the taxes paid by the IPP, substantially concurrently with its payment of those taxes, permits a "pass-through" of the tax. A contract which contains energy payment escalators which may be affected by the tax may in the broadest sense allow the IPP to "recover" at some later date some portion of taxes paid, but there may be no easily quantifiable correlation between the "recovery" and the taxes, and the result in each case will depend on how the specific contract is written. A 1992 survey by NIEP of existing power sales agreements between independent generators and utilities found that none of these contracts contained provisions permitting the independent generator to pass through to the utility increased costs due to changes in law, including taxes.² The ability of a wholesale electric supplier to pass through or recover a fuel tax depends on the nature of the contract energy payment provision.³ For instance, in cases where the energy payment is based on fuel market indices which may be affected by the tax, the IPP may recover some portion of the tax at an uncertain date, sometimes years later, but there is no direct pass-through of the tax and full recovery of taxes paid is unlikely.

- fixed over the term of the contract based on administrative determination of long range avoided costs (no pass-through or recovery permitted);
- adjusted from a base to reflect a general economic index, such as inflation (no pass-through permitted; delayed recovery only to the de minimis extent that a tax-related rise in fuel costs affects the Consumer Price Index, a general measure of inflation);
- adjusted from a base to reflect energy market conditions and/or purchasing utility's cost of fuel (no pass-through permitted; partial, delayed recovery only to the extent that fuel indices and utility's own cost of fuel, as applicable, reflect tax; it is unlikely that wholesale generators would recover any significant portion of taxes paid);
- in a few contracts, such as California Standard offer contracts, indexed to reflect market conditions by a mechanism established by state regulatory commission rule or policy (no pass-through permitted; nature and extent of recovery contingent on obtaining commission approval for recovery of tax-related costs; even if approval given, major delay may be involved); and
- some combination of the above, so that at different times during the contract term a single IPP would be subject to varying amounts, if any, of recovery.

III. NIEP'S PROPOSAL FOR A FAIR AND EFFICIENT ENERGY TAX

NIEP believes the key to developing a fair energy tax is its collection point, the place in the stream of commerce where the tax is imposed. Under the Administration's February proposal, the tax would be collected upstream at the minemouth for coal, the entry into the refinery for oil, the pipeline for natural gas, the production facility for alcohol fuels, point of importation for imported power and petroleum products, and the utility for hydro and nuclear-generated electricity. The Administration's modified plan announced earlier this month would move some of these col-

¹ In enacting the electricity provisions of the Energy Policy Act of 1992, Congress strongly endorsed the benefits of competition in electric power markets by removing barriers to entry caused by the Public Utility Holding Company Act and opening access for wholesale suppliers to electric transmission facilities.

² By contrast, electric utilities are entitled to pass through to or recover from their ratepayers all prudent costs related to changes in law or regulation. In many states, utilities have automatic fuel adjustment clauses which allow price increases attributed to taxes to be passed through and, in the remaining states, utilities can routinely seek and receive regulatory approval for reimbursement from their ratepayers.

³ Energy payments may be:

lection points slightly downstream, placing the tax on the purchaser for coal, at the refinery tailgate for oil and on the local distribution company or other purchaser for natural gas; alcohol fuels would be exempt and the other collection points would remain the same. Under both proposals, the seller of gas, coal, oil and other non-exempt fuels would collect the tax from the wholesale generators at the point of sale before the fuel is used to produce electricity. As noted above, NIEP believes that a tax in this form will have the unintended consequences of damaging the economic viability and competitive position of the independent power industry.

NIEP recommends that the tax be imposed downstream at the burner tip (retail consumption point for natural gas) or retail electric meter. This collection point would eliminate pass-through problems for utilities and wholesale generators alike.

Alternatively, the tax should be imposed only on the utility purchasing electricity at wholesale either at the busbar (where electricity goes from the generation station to the grid, after the point of sale to the utility) or the substation (where the high voltage transmission lines deliver energy which is stepped down to distribution voltages for retail sale). The tax would be based on the Btu content of the fuel mix in the utility purchase.

NIEP believes that this downstream collection proposal better serves the stated objectives of the Administration in proposing the tax. The following objectives have been cited by Administration officials as guiding the design of the energy tax:

1. The tax must increase revenues by \$71.4 billion over the 1994-1998 period, or about \$22 billion per year by 1998.
2. The tax should have a reasonably balanced impact on different regions of the country.
3. The tax should be easy to administer.
4. The tax should reduce dependence on foreign sources of energy.
5. The tax should reduce environmental damage and promote energy conservation.
6. The point of collection should minimize the number of taxpayers or tax collectors and ensure that imported and domestic products are taxed at the same rate and that fixed-price contracts do not prevent pass-through of the tax to the end user.
7. Independent power producers should not be competitively disadvantaged by the tax.

IV. NIEP'S PROPOSAL COMPORTS WITH THE GOALS OF THE ENERGY TAX

NIEP's proposal for a downstream collection point either at the retail burner tip/retail meter or busbar/substation would better serve these objectives than the Administration's upstream proposals:

A. Ease of Administration

There are approximately 3000 electric utilities with retail distribution franchises in the United States. Most of these regulated utilities already collect taxes for state and local governments. They are also accustomed to being regulated on a cost accounting basis. The most efficient way to collect the tax is to have it imposed on the retail ratepayer at his electric meter and collected by the utility. If instead, the tax is to be imposed on the purchasing utility at the busbar or substation, steps should be taken to insure that utilities can pass the tax through to ratepayers. Utility fuel adjustment clauses allow regulated utilities, but not independents and other wholesale generators, to pass Btu taxes through to ratepayers. Because of their obligation to serve, regulated utilities are entitled, under state law, to recover from their customers all prudently incurred costs, including taxes. All but six states have fuel adjustment clauses. These clauses, introduced in the 1970s during the period of highly volatile fuel prices, allow utilities to quickly adjust rates to assure fuel cost recovery rather than wait for a periodic rate proceeding. However, many of the fuel adjustment clauses have caps on the amount of adjustment permitted annually. Some utilities may, therefore, not be able to recover all tax payments unless normalization rules or other measures are adopted by the Congress to assure full pass-through. We endorse efforts to assure that utilities can recover the tax from their ratepayers.

The Administration's modified proposal would be very difficult to administer. By requiring each IPP to pay the tax and then, if the IPP is party to a certain type of contract, to apply for a credit later, the Administration's proposal would involve the Internal Revenue Service (IRS) in difficult assessments of complicated energy pricing provisions in contracts throughout the country. By not addressing the production of steam from waste heat in cogeneration facilities, the Administration invites extended disputes concerning the allocation of fuel used by cogenerators to produce both electricity and steam. By confining the proposed tax credit to IPPs who

are party to existing contracts, the proposal creates substantial uncertainty as to the effect of any amendments to those contracts (and difficulty in administering decisions as to whether any amendment is related to the tax). In addition, to deal with alleged windfall problems where energy payments may vary under a contract, some have proposed complicated schemes for reducing or eliminating the IPP credit or deferral if an IPP receives any payments that may be increased (no matter how indirectly or delayed) by the amount of taxes paid by the utility, which would involve the IRS in additional byzantine contract interpretation and allocation issues.

NIEP's downstream proposals avoid all of these problems.

B. Conservation

If one goal of the tax is to create incentives to conserve energy, the entity which pays the tax should also be the one that controls the consumption of fuel. As Secretary Bentsen stated on April 1, 1993, in releasing the Administration's modified proposal, "If the tax is to effectively promote energy conservation, it must be borne by the ultimate consumer. The Administration is continuing to explore methods of assuring that the tax is in fact passed through to those who use the energy." A tax imposed on wholesale generators will not reduce consumption because they are required by contract to deliver power on demand from their utility purchasers. It is the purchasing utility which determines which generating unit on their system will be called upon. The utility also has an obligation to serve its ratepayers by meeting their demand for electricity. A retail tax or a tax on the utility with assured pass-through to retail customers is more likely to change retail consumption patterns to promote energy conservation.

Imposing the tax on wholesale generators also would not encourage fuel switching, as some have suggested. Although utilities can and do choose among power generators based on the type and cost of fuel used by each, once an IPP has built its plant it is locked into its chosen fuel in all but a very few instances, where plants have been built to run on more than one fuel. In these plants, the operator already has significant incentives to use the lowest-priced fuel; the capacity to use more than one fuel exists solely as a backup in case of supply interruptions on cheaper fuels.

However, policymakers are usually strongly opposed to placing any tax at the retail level for several reasons:

- Visibility. Consumers will be upset if a new tax item is added to their electricity bill.
- Ease of administration, both the ability to enforce collection and the desire to minimize the number of people paying the tax. As discussed above, however, utilities generally are efficient tax and bill collectors.

The energy tax is hardly the stealth bomber of the President's comprehensive deficit reduction plan. Moreover, utilities generally do not, or need not, break-out specific cost items, including taxes, on retail customer bills. In announcing and discussing the tax, the Administration has been explicit in its public statements about the consumer impact of the energy tax.

C. Minimize Interference in Markets

The downstream collection point for the tax on electricity fuels would minimize disruption of competition by avoiding the creation of winners and losers in the electric generation market. Since wholesale generators and traditional cost-of-service facilities will be treated the same with regard to pass-through of the tax, the tax will not interfere with competition between independent power producers and traditional utilities over the right to build new facilities.

D. Revenue Impact

We note that the downstream collection point may result in a loss of projected revenues from the tax because of losses of energy as collection moves down the stream of commerce. We recognize that it may be necessary to adjust the Btu tax rate to make up any significant losses in revenue, consistent with the goal of deficit reduction.

V. OTHER PASS-THROUGH OPTIONS

Several other options for dealing with the pass-through problem have been considered:

- "Grandfather" existing contracts of wholesale producers with terms greater than one year by exempting fuel used in such facilities from the tax. While this proposal would prevent financial hardship to existing facilities and likely have minimal revenue impacts, it would give new utility cost-of-service plants with

automatic tax pass-through a competitive advantage over contract suppliers who compete with them for the right to build new capacity, but must bargain for the right to pass-through fuel taxes.

- Give wholesale generators a tax credit or rebate for taxes paid on fuel. This proposal exempts such fuel from tax all together, is expensive to administer, and sets a bad precedent for other industries which could "snowball" into substantial revenue impacts. Nonetheless, this approach, together with imposition of a tax on electricity purchased by utilities under existing fixed-price contracts, appears to be the course chosen by the Administration in its modified proposal.
- Defer collection of the tax on fuel used for generation of electricity subject to long-term contracts—have the tax collected by the purchasing utility at the busbar or substation. If the decision is made to have an upstream imposition of the tax, this is NIEP's preferred solution to the pass-through problem. It has the disadvantage of somewhat cumbersome tax deferral certificates or rebates. It also does not deal with the problem of fuel lost, in transportation or otherwise, between the point of imposition and point of combustion, or losses of electricity resulting from transmission from the generating plant to the substation.

VI. WHY PASS-THROUGH FOR FUTURE PROJECTS IS IMPORTANT

Pass-through of energy taxes for future as well as existing IPP projects is important to the future of the independent power industry. At first glance, this may not appear necessary. Unlike existing facilities locked into long-term contracts, developers of future projects may negotiate new contracts which theoretically could take the possibility of future tax increases into account. This argument does not reflect the realities of competition in the energy industry however. Utilities and IPPs compete to gain the right to build power plants, with the utility often in the position of being both a competitor and the judge of the contest. In this situation, the utility has no incentive to agree to tax pass-throughs, and IPPs' inability to pass the tax through for new contracts would undermine the Administration's stated purposes for the tax of promoting energy conservation by end users and not putting IPPs at a competitive disadvantage in the electric power markets.

Because fuel costs are 80-90 percent of a fossil fuel-fired facility's variable costs, IPPs may have difficulty financing their plants if they must bear the risk of future tax increases on fuel. This will be especially true in the future if the precedent and mechanisms for energy taxes are established in 1993. At the same time, contractual provisions permitting recovery of the tax most likely would not be available. Utilities which purchase electricity from IPPs are very reluctant to assume tax risks through some form of contract pass-through provision without assurance in advance that their regulatory commissions will allow them to recover the costs of tax payments. State regulators, on the other hand, have typically resisted any advance approval of contract terms which bind future commissions, hence the need for the Administration's normalization proposals to encourage pass-through.

These difficulties would create an artificial incentive for utilities to build rather than buy new capacity, thereby undermining the competitive market for wholesale power. If a utility builds its own facility on a cost-of-service basis, it has a high probability of being able to pass energy taxes through to ratepayers along with other "prudently incurred" costs, either through a fuel adjustment clause or in a rate proceeding. Of course it is possible that state regulatory commissions will insist that fuel taxes be passed through or not in the same manner for both utilities and IPPs, but this is unlikely given the different regulatory schemes for utilities and IPPs.

For these reasons, one cannot simply say that the tax risk is just another negotiating point and that utilities will agree to pass-through if they get enough in return for carrying this risk. This would be true in a perfectly competitive market, but that is not the real world for IPPs. Further, there is no reason why this tax should be structured so as to give utilities another bargaining chip over IPPs. Even in states with commission-sanctioned competitive bidding, electric utilities compete with IPPs for the right to build new capacity and the utilities already have significant bargaining leverage over IPPs. If the ability to pass-through taxes were greater for electric utilities than for IPPs, such as would be the case if the default position is that the IPP pays the tax without a pass-through, competition would be tilted against IPPs in favor of the cost-of-service facilities and the policies of PURPA, the Energy Policy Act of 1992 and other statutes passed by Congress to encourage alternative sources and increased efficiency in the production of electricity would be undermined.

The best solution for this problem is either to have the tax imposed on electricity fuels at the retail level or to include in the tax legislation a federal mandate that utilities be allowed to pass through such taxes in their fuel adjustment clauses or

other cost recovery mechanism. In any case, it makes sense for the IPP pass-through provision now being considered by the Treasury to apply to future as well as existing facilities.

Allowing the tax pass-through provision to apply to future as well as existing facilities does not add to IRS's administrative burden. Utilities could continue to collect the tax at the recommended collection point in the future under the system already established for existing facilities.

Finally, we should point out that there also is precedent in the Clean Air Act Amendments of 1990 for giving IPPs prospective as well as retrospective relief in order to ensure fair competition between utilities and IPPs. In the original acid rain proposal submitted to Congress, IPPs were not allocated sulfur dioxide (SO₂) emission allowances, but were required to hold allowances equal to their emissions. By contrast, utilities were allocated sufficient emission allowances to comply with new standards. Congress recognized that this created an inequity which would harm the emerging competitive electricity markets. To ensure retrospective relief, Congress "grandfathered" existing IPP contracts. In addition, to put new IPPs and new utility plants on a equal footing, Congress created sources of allowances specifically for IPPs to enable them to compete fairly with utilities.

VII. TREATMENT OF FUEL USED TO GENERATE STEAM

Cogeneration facilities produce energy in the form of electricity and steam. Since passage of the PURPA, Congress has favored cogeneration as a means of capturing waste heat from combustion of fossil fuels, converting it to steam, and using it to provide heating and cooling to an adjoining industrial customer and/or to generate additional electricity through steam turbines. The thermal efficiency of such facilities is much greater than would be the case if the waste heat from the production of either steam or electricity were simply vented into the air. As Vice President Gore noted in *Earth in the Balance*, "Laws encouraging and even requiring the efficient use of cogeneration technology have an important role to play in reducing the consumption of fossil fuels." (p. 329).

The impact of the proposed energy tax on steam sales by cogeneration facilities was not specifically addressed in the original Treasury proposal nor the Administration's modified proposal. However, we believe that not only should the tax be neutral with respect to the economic incentives to cogenerate, but in keeping with the Administration's policy goals in designing the tax and the congressional policies encouraging cogeneration discussed above, it should encourage, and not discourage, cogeneration.

The Treasury proposal would tax the Btu content of fossil fuels, not electricity or steam produced per se. If IPPs, as purchasers of fuel, cannot pass through the taxes levied on these fuels upstream to the buyers of their electricity and steam, the financial viability of all projects will be impaired and, in some cases, destroyed given the tight margins in this highly competitive industry. So long as the steam is produced from waste heat captured in the process of burning fuel to generate electricity, with no use of additional fuel solely to produce steam, the tax on that fuel is fully and fairly captured by taxing the electricity generated in the process.

With respect to the tax treatment of the fuel used to generate steam in a cogeneration facility, we propose the following:

- In keeping with existing federal incentives for energy efficient cogeneration, the fuel used in a qualified cogeneration facility which produces steam from waste heat should not be taxed.
- To the extent a cogeneration facility produces steam directly from fuel, and not from waste heat, that steam is an "alternative energy" source to which the tax should not be applied, together with the fuel used to produce that steam.

VIII. EXEMPTIONS FOR NON-CONVENTIONAL FUELS

The Administration proposes to exclude certain "non-conventional" fuels from the Btu tax, including solar, geothermal, biomass, wind and now ethanol, methanol and other fuels. It has been suggested that certain additional fuels should be considered "non-conventional" fuels, including waste fossil fuels used for the generation of electricity, such as waste coal and petroleum coke. While NIEP takes no position on tax exemption for individual fuels, the following data may be helpful.

A. Exemptions for Other Non-Conventional Fuels

In its regulation of qualifying facilities under PURPA, the Federal Energy Regulatory Commission (FERC) defines waste as "an energy source that has essentially no commercial value." Because the Btu content of waste coal is low compared to gas, oil and even conventional coal, a greater volume of it is required to produce a kilo-

watt-hour (kwh) of electricity. A Btu tax, when imposed on a low Btu, low value fuel, has a disproportionate impact on the price of electricity produced from such fuel. In addition, we note that unlike other renewable fuels which have been exempted, the Administration has proposed to tax hydroelectricity at an average Btu value for fossil fuels. Such a formula greatly understates the very high efficiency of hydroelectricity. This raises the question whether taxing such sources at the same rate as conventional coal or oil puts an unfair burden on the user.

By including waste fuels in the definition of qualifying small power production facilities under PURPA, Congress sought to encourage the use of these resources for many of the same public policy reasons that the Administration proposed to exempt "non-conventional" fuels—that is, promoting energy efficiency, reducing dependence on foreign energy sources and improving the environment. In 1990, Congress reinforced its preference for such fuels by removing size limits on these technologies originally imposed by PURPA.

For example, recent developments in technology over the past few decades have made it possible to use waste coal as a fuel to generate electricity and steam. About three billion tons of waste coal sit on land adjacent to current and former coal mines. These piles, many of which have been abandoned for decades, pose environmental hazards because they leach acid into groundwater, blow dust into the air, catch on fire or slide down into roads. Despite these hazards, the companies which own them and are still in business cannot afford to clean up these areas. Rather than eventually forcing a state or local government to foot the bill for clean-up, waste coal can be used as a fuel for electricity and steam generation.

Other waste technologies, such as petroleum coke, a by-product of petroleum refining, when used as generating fuels, may provide additional economic benefits to a region and result in the more efficient use of domestic oil. Also, these combustion technologies must meet the strictest new source standards for their emissions.

The decision whether to provide an exemption of waste fuels from the proposed Btu tax or other relief for low Btu waste fuels will depend on an assessment of the net societal environmental and economic benefits from using waste coal, petroleum coke or other resources to generate electricity.

B. Elimination of Double Taxation of Energy Storage Technologies

Energy storage technologies, such as hydroelectric pumped storage and compressed air energy storage, represent a unique resource by consuming low-value surplus power during periods of low demand to store energy for use during periods of high demand. More than 20,000 MWs of energy storage are now in various stages of planning and development by independent power producers, utilities and public agencies. Under the current Administration proposal, hydroelectric pumped storage would not be taxed twice,⁴ but electricity generated from other energy storage facilities may be subject to a direct double-level tax.

A tax would be imposed on the fuel used to generate the electricity used to store energy. An additional tax would be imposed on the power used to generate electricity from the energy storage facility.

Energy storage facilities compete directly to produce peaking power with technologies such as gas turbines. In the case of gas turbines, the natural gas burned to generate electricity would be taxed, but not the electricity produced. To double tax energy storage would place it at a competitive disadvantage relative to other peaking resources. In addition, in some cases, the tax could disadvantage independent energy storage facilities relative to utility-owned facilities.

By excluding hydroelectricity produced from pumped storage in its modified proposal, we believe the Administration has recognized the validity of these arguments. In drafting legislation, care must be taken to ensure that the same treatment to electricity generated from all energy storage facilities. The tax would continue to be imposed on the fuel used to produce the electricity used for storage.

IX. CONCLUSION

The proposed downstream tax collection point best serves the Administration's stated objectives for the energy tax. It ensures that all fossil fuels used to produce electricity will be taxed. It does not give cost-of-service facilities with pass-through capability a competitive advantage over contract suppliers. It reduces the number of taxpayers, increases administrative simplicity and gives the responsibility for tax collection to the most sophisticated entity in the electricity stream of commerce. Further, it advances energy conservation by ensuring that those entities with the

⁴ Although, as noted above, unlike other renewables, the proposal would tax hydro electricity at a relatively low efficiency which does not reflect its true efficiency.

discretion to control energy consumption—utilities which control dispatch of contract generators and ratepayers who control demand for power—either collect or pay the tax.

Alternatively, the Administration's April 1 proposal should be modified to remove the cumbersome tax-and-credit method for deferring taxes on fuel used to produce electricity, where a utility pays the tax based on electricity it purchases from the IPP under a "fixed-price contract," without regard to when the contract was signed.

PREPARED STATEMENT OF LELAND H. SWENSON

Thank you, Mr. Chairman, and members of the committee for giving me the opportunity to appear before you today to comment on the potential impact of proposed energy taxes on the agriculture and rural sectors. My name is Leland Swenson and I serve as President of National Farmers Union, a general farm organization representing over 250,000 farm families.

The members of National Farmers Union support the basic concepts outlined in President Clinton's economic program. We believe there is a need to stimulate the economy, to invest in people and the nation's infrastructure, to reduce the federal deficit, and to reform the nation's tax system. NFU commends the president for offering a plan to begin that process.

However, I would be neglecting my duties as a representative of a general purpose farm organization if I did not point out that production agriculture has already contributed a great deal to reducing the national debt.

As noted by the attached chart, agriculture is the only entitlement program that has experienced a reduction of outlays in the past and is scheduled for even more reductions in the future. The original version of the economic plan proposed cuts of \$6.7 billion in the agriculture sector over the five-year period. This figure was revised downward to \$4.5 billion by the Fiscal Year 1994 Budget Resolution. NFU is very appreciative of the recognition which Congress has shown of agriculture's past contributions to reducing the deficit by making this change. Of the total cuts, \$2.6 billion are to come from mandatory farm program spending, some of which begin in FY 1994, with the larger cuts anticipated beginning in FY 1996.

Because of their potential effect on both net farm income and the future competitiveness of agricultural exports, the National Farmers Union has serious reservations concerning both the BTU tax proposal and the proposed increase in the inland waterways fuel tax.

Getting straight to the point, if farm income were up, there would be much less concern about the potential implications of these energy taxes on our industry and on rural America.

To give you a brief snapshot of the financial condition of agriculture, based on current farm programs, the USDA World Agricultural Outlook Board in January estimated that 1993 net farm income would be in the range of \$42 to \$48 billion, down from the \$51 billion level for 1992. At the midpoint level of this range, that would be a 12 per cent drop in net farm income. At the extreme, it would be a 17 per cent decline. These declines are coupled with expected increases in farm input costs of approximately two per cent.

According to USDA, 75 per cent of all farms are categorized as "small," with sales of \$50,000 or less. The majority of small farmers lose money on their farms. In 1990, two-thirds lost money (on an average a negative \$3,387). These farm families remain solvent only through earnings from off-farm jobs. Another 25 percent had a positive return, but netted less than \$10,000 from farming operations in 1990. Twenty-two percent had sales between \$50,000 and \$249,999. The average farm income for these producers was \$16,236.

Following the Agricultural Outlook Conference, on April 1, the Food and Agricultural Policy Research Institute (FAPRI) at the University of Missouri released an analysis of the impacts of the Clinton economic package on U.S. agriculture.

FAPRI estimated that when fully phased in, in 1998, production costs for corn associated with fuel and lubrication, fertilizer, chemicals and custom harvesting operations are expected to increase by \$2.34 per acre due to the BTU and inland waterways tax proposals. For cotton, the same energy-related categories increase by \$3.37 per acre. Farm production expenses for fertilizer, petroleum fuels and oils, electricity and custom work are expected to rise by \$690 million in 1998 under the proposed energy tax package. Net farm income is affected 2.3 per cent, or \$1.2 billion by the total economic package, including the energy tax portion.

To put these statistics into perspective, North Dakota State University recently estimated that the BTU tax alone will cost North Dakota farmers about \$1 per acre for wheat, barley and sunflowers. The average North Dakota farmer would, therefore, find his net farm income reduced by approximately \$1,200 per year, out of a net farm income in that state of around \$17,000 annually.

Similarly, a study done in my home state by South Dakota State University showed the impact of the proposed fuel tax in its third year of phase-in. On a typical 600-acre farm in southeast South Dakota, SDSU estimated the tax would reduce net farm income by more than \$2,400 per year.

FAPRI also estimates that the increase in the inland waterways fuel tax will add a 5.4-cent-per-bushel price wedge for wheat, 6.6 cents for soybeans, and 6.5 cents for corn. These increased costs will be directly borne by the farmer. Part of the effect of the tax will be mitigated as an additional portion of grains and oilseeds move via truck or rail. However, in the past the rail system has increased its rates roughly three cents for every 10-cent increase in barge costs.

As the FAPRI study also noted, some of the costs associated with the increased energy taxes may be offset by reductions in interest rates. But, in the crops sector, interest offsets no more than one-third of the added costs from higher energy taxes, according to FAPRI. And, in the event an interest rate decline does not occur, further reductions in net farm income can be expected. Anticipated offsets from changes in the Earned Income Tax Credit (EITC) will do little to help the small farmer, whose average age is 55 or older. Nor will allowance of an Investment Tax Credit (ITC) because that proposal makes no provision for using the credit for purchases of used equipment, which is the type of equipment often purchased by small farmers.

Modern agriculture is an energy-intensive industry which has few alternatives to traditional energy sources. Today, American farmers directly account for 2.5 per cent of all the energy used in the U.S. Indirect costs associated with agricultural production, such as costs of transporting products to market as well as production inputs, raise the farmers' share of energy consumption to nearly five per cent of the U.S. total.

On April 1, in announcing modifications to the energy tax plan, Treasury Secretary Lloyd Bentsen said, "If the tax is to effectively promote energy conservation, it must be borne by the ultimate consumer. The Administration is continuing to explore methods of assuring that the tax is in fact passed through to those who use the energy."

We understand this statement, however, in the agricultural sector this is just not practical. Independent farmers and ranchers have virtually no way to "pass through" the increased burdens (direct on fuel consumed in farming and indirect in higher commodity transportation prices and other farming costs) to the "end users" of the food and fiber. Agricultural

commodities must compete on the world market. In 1992, agricultural exports totaled nearly \$40 billion, cutting our deficit in non-farm trade by about 14 per cent. Increasing production costs would further lower net farm income as well as render U.S. agricultural products less competitive.

If the costs of inputs rise further (energy used directly in farming as well as fertilizer, for example) the farmer will have to fully absorb those costs. Unlike the retailer and other small businesspersons, the small agriculture producer has no control over the prices he receives for his commodities. To whom can he pass on the increased costs he will pay due to these energy taxes?

In addition, we have concerns about the BTU tax beyond its effect on agriculture as an industry. According to the Census Bureau, each rural family generates 62 per cent more in daily auto travel than do families who live in metropolitan areas. Only one per cent of rural workers have access to public transportation. Heating and cooling costs for rural structures can average 15 per cent more than for metropolitan homes and offices due to the isolated, exposed positions of rural buildings, higher energy distribution costs, and the age and condition of rural structures. Thus, the implications of increased energy costs impact rural communities in other ways besides the potential loss of additional family farmers.

National Farmers Union understands all too clearly the concern over huge federal deficits, and we are willing to do our fair share to reduce those deficits. We have requested that the administration and Congress provide an economic model to reflect accurately the total ramifications of this proposal on agriculture and rural communities.

Proposed Solutions

1. NFU believes there are a number of potential solutions to reduce this economic burden which merit consideration, the main one being an increase in net farm income.

That solution, which we know is beyond the jurisdiction of this committee, is to design farm programs to allow for greater agricultural income in order to offset the increase in the BTU tax. Increasing farm income would be the best possible boost for agriculture and for the rural economy. NFU has continued to express a willingness to work with Congress and the administration to design farm programs that will provide greater marketplace income for producers. These programs could include higher loan rates, higher Acreage Reduction Program (ARP) rates, implementation of the Targeted Options Program (TOP), a marketing loan program, and implementation of the bushel-base program.

2. An alternative would be to provide an agricultural exemption for all or a percentage of the tax so that agriculture pays a share proportionate to that of other sectors.

3. Another option would be to eliminate the energy tax measures altogether and cut back on an equal amount of investment proposals.

4. Consideration could be given to elimination of the energy tax measures and, instead, secure needed revenues from a more progressive tax source, such as the income tax.

5. Another approach would be to provide a credit for energy generated by renewable sources, such as windmills or solar panels.

In conclusion, National Farmers Union respectfully asks this committee's careful review of the impact of energy taxes on agriculture and rural America, particularly in light of poor commodity prices and the condition of the farm economy.

Top Entitlements

Mandatory spending programs account for more than half the federal budget. Their sheer size makes the biggest of them tempting targets for budget cutters, but the critical factor is how fast they grow. Medicaid and Medicare combine size with an explosive growth rate that makes them the two most serious budget problems in the short run. Social Security will become a similar problem when the baby boomers begin to retire early in the next century. The following are the top 12 entitlements, ranked by size. (By fiscal year; dollar amounts in billions.)

| Rank/Program | Actual '91 Outlays | Annual Average Percent Change | |
|---|-----------------------|----------------------------------|-----------------|
| | | 1985-91 | 1991-97 |
| 1. Social Security | \$267 | 6.2 | 5.8 |
| 2. Medicare | 114 | 8.6 | 11.6 |
| 3. Deposit insurance | 66 | NA ¹ | NA ¹ |
| 4. Medicaid | 53 | 15.0 | 15.8 |
| 5. Federal civilian retirement ² | 37 | 6.2 | 6.9 |
| 6. Unemployment ³ | 25 | 8.0 | 0.7 |
| 7. Military retirement | 23 | 6.6 | 5.7 |
| 8. Food Stamps ³ | 20 | 8.1 | 4.0 |
| 9. Supplemental Security Income | 15 | 9.1 | 9.4 |
| 10. Family support | 14 | 7.8 | 5.3 |
| 11. Veterans' benefits | 14 | 2.4 | 4.6 |
| 12. Farm price supports | 10 | -9.0 | -1.4 |

¹ It is misleading to calculate the year-to-year change in deposit insurance outlays. The savings and loan crisis forced Congress to supplement deposit insurance — ordinarily funded solely by premiums from covered institutions — with huge sums of taxpayer money. The annual amount of taxpayer funds depends on the vagaries of congressional politics.

² Includes civil service, foreign service, Coast Guard and other retirement programs, plus annuitants' health benefits.

³ Unemployment insurance and food stamps are "countercyclical" or "automatic stabilizer" programs designed to counteract the effects of an economic downturn. Much more than most other entitlements, their year-to-year growth rates and total spending are dictated by the health of the economy.

SOURCE: Congressional Budget Office

SPECIAL ORDER OF BUSINESS

CLINTON ECONOMIC PLAN

Adopted at the National Farmers Union Convention
March 5-8, 1993

We commend President Clinton for presenting an economic stimulus proposal designed to bring down the federal deficit, put people back to work, and get the economy moving again.

We also commend the President for moving swiftly to reorganize and streamline the federal government bureaucracy. We further commend him for preparing a plan to streamline the U.S. Department of Agriculture in order to make it more "farmer friendly."

We, the members of the National Farmers Union, support President Clinton in these endeavors as long as there are plans in place which provide agricultural producers a fair and equitable income.

Due to the present depressed economic condition on America's family farms, individual producers should not be assessed additional taxes which cannot be recovered from the marketplace.

In particular, because the agriculture industry is heavily energy dependent, being the nation's fifth largest user of energy, the proposed BTU tax will have a particularly detrimental impact on this sector of the economy.

NFU favors targeting farm program benefits over means testing. Targeting farm program benefits to the production levels of family farm operators would reduce government costs while furthering the sustainability of our family farms, our rural communities, and our national economy.

While NFU agrees that rural development projects are important, we strongly believe the fastest way to revitalize rural America would be through increasing the profitability of the family farmer. Every dollar generated by a family farm operator is re-invested seven times throughout the economy.

Therefore, it is imperative that National Farmers Union, representing more than 250,000 of America's family farmers, be intricately involved in working with the Clinton Administration to develop economic models which accurately demonstrate the ramifications of these proposals on family farm agriculture and rural America.

We applaud Secretary of Agriculture Mike Espy's announcement, at our 1993 annual convention, of the Clinton Administration's intent to have a close working relationship with members of National Farmers Union. The National Farmers Union enthusiastically accepts this offer to work with the Clinton Administration to design a farm program that will target benefits to family-sized farms while at the same time reducing the federal budget deficit.

SPECIAL ORDER OF BUSINESS

Inland Waterways Fuel Tax

Adopted at the National Farmers Union Convention
March 5-8, 1993

National Farmers Union is opposed to the proposed 525 percent increase in the Inland Waterways Fuel Tax contained in the Administration's economic proposal.

A comprehensive strategy for improving the economic condition of U.S. agricultural producers must include improvements in commodity transportation systems. Maintaining export competitiveness, conserving energy resources, and increasing the farmers' share of the consumers' food dollar are objectives which necessitate close vigilance of factors affecting transportation costs.

Barges within inland waterways transport over half of all exported grain. Barges use less fuel per ton-mile than any other bulk commodity system, and the low-cost operation of barge transportation minimizes the downward pressure on producer prices by lessening the total cost of food delivery.

Initial studies estimate that this proposal will increase the cost of barging grain by about \$.10/bushel, in addition to the \$.10/gallon BTU tax also proposed. We firmly believe that such cost increases will be borne disproportionately by U.S. farmers. Therefore, we request the leadership of National Farmers Union to urge Congress to reject this proposed tax increase in the Inland Waterways Fuel Tax.

NATIONAL FARMERS UNION
91ST ANNIVERSARY CONVENTION
SIOUX FALLS, SOUTH DAKOTA
MARCH 5-8, 1993

SPECIAL ORDER OF BUSINESS

INCREASING COMMODITY LOAN RATES

WHEREAS, the Clinton Administration has proposed a comprehensive economic plan designed to stimulate the national economy and reduce the federal deficit, which we believe to be worthwhile goals; and,

WHEREAS, a healthy farm economy is essential to a healthy national economy; and,

WHEREAS, during the past 12 years farm commodity prices have continually decreased while farm production costs have risen dramatically, resulting in a negative impact on our nation, especially its rural areas; and,

WHEREAS, the most important first step which can be taken to revitalize the United States would be to allow agricultural producers to receive prices which equal the cost of production, plus a reasonable profit; and,

WHEREAS, an increase in commodity loan rates will have an immediate positive effect on increasing commodity prices which, in turn, will help achieve this Administration's goals of revitalizing our country; and,

WHEREAS, increasing commodity loan rates also will result in a net savings in total farm program costs because of a significant savings in deficiency payments, thereby helping to reduce the federal deficit.

THEREFORE, the National Farmers Union calls upon Secretary of Agriculture Mike Espy to immediately utilize his discretionary authority under the law to increase commodity loan rates to strengthen market prices so that farmers once again will receive more of their income from the marketplace, rather than from the federal Treasury.

Excerpts from 1993 National Farmers Union Policy Program

We are deeply concerned over the adverse potential impacts of across-the-board national energy taxes such as the proposed BTU tax upon agriculture. We believe that such energy taxes would be both regressive in nature and inflationary.

Farmers have had little opportunity to respond to increased costs of petroleum products, electrical power, and other energy sources, and cannot recover these increases through meaningful reductions in consumption. Unless there are programs to provide

significant offsetting gains in agricultural income, such energy taxes will only serve to further the cost-price squeeze on the agricultural production sector and force more family farmers out of business.

We oppose efforts to force conservation through excise taxes, and support the continuation of the farm-use exemption from such taxes. We also oppose excise taxes on gasoline for deficit reduction purposes, since they fall hardest on those in rural areas.

Because many of the mechanics of the proposed BTU tax are still unknown, we direct the NFU board and staff to develop legislative alternatives, including the use of tax credits, which would offset the costs of the energy tax upon family farmers.

PREPARED STATEMENT OF SENATOR MALCOLM WALLOP

Thank you Mr. Chairman for holding this hearing on a subject of immense concern to me, and thank you Mr. Secretary for appearing before us again to discuss the administration's Btu tax proposal.

Mr. Secretary, when you appeared before us last, I had asked you a number of questions about the Btu tax and its implementation. At that time details of the tax were not available although you expressed some interest in ironing out particular problems. Now I see that you have released additional details, including collection point changes and many new exemptions.

But no matter what changes are made to this tax, it will still increase the cost of U.S. products and will place U.S. manufacturers at a competitive disadvantage vis-a-vis our major trading partners. This is true because the cost of the tax is built into the sales price so it cannot be rebated at the border nor can it be imposed on foreign manufactured goods sold in the U.S.

The Btu tax will be particularly onerous to energy-intensive industries such as aluminum, steel, glass, paper, chemicals and plastics. These industries not only use a high percentage of energy in the production of their product, but they are also among some of the most competitive U.S. industries in world markets.

I understand that treasury has estimated that the tax will result in a 4-percent price increase for energy-intensive industries. As you may know, many of these companies operate on slim margins, so a 4-percent increase in costs would wipe out their profits. For example, one paper company found that a 2-percent increase in production costs is more than their entire profit margin.

Although you argue that the Btu tax will have only a negligible impact on the cost of U.S. production, we can not forget that this is a *permanent tax* and it will have a permanent impact. History should remind us that the rate of tax will only increase in our inevitable search for new revenue.

In fact, the *New York Times* reported only yesterday that the administration is considering a proposal from Vice President Gore to commit the U.S. To freezing by the year 2000, greenhouse emissions at 1990 levels. Assuming this new policy is announced, it seems to me that there will be increased pressure in the near future to raise the Btu tax rates substantially in order to meet his new commitment.

So even conceding your claim that the impact on U.S. manufactured goods is small today, it will be large tomorrow and by then it may be too late. We should have learned a lesson in 1986 when we implemented the AMT tax system. Now we find that U.S. companies paying AMT recover their capital costs much slower than other companies and we have to reform the tax because businesses are strapped for cash and forced to layoff workers.

Of course, industry can adjust to the new costs of the Btu tax. It can move production overseas, or decrease the wages of its American workers to remain competitive. But exporting jobs, as the President decried during his campaign, is not the way to achieve economic prosperity. It seems to me that we should be helping to make these industries even more competitive to ensure American productivity and to maintain American jobs. We should not continue to put American businesses at a disadvantage.

COMMUNICATIONS

STATEMENT OF THE ALUMINUM ASSOCIATION

Summary of The Aluminum Association's Energy Tax Position

The U.S. aluminum industry supports President Clinton's efforts to reduce the federal deficit. One aspect of the President's plan calls for the enactment of a British thermal unit (Btu) tax on energy. It also provides that non-fuel uses of energy will not be taxed.

Electricity used in the process of smelting primary aluminum, as well as petroleum and coal derivatives in carbon anodes and cathodes are non-fuel uses that should not be subject to the President's Btu tax proposal. There are no substitutes for these non-fuel uses.

The Btu tax attributable to non-fuel uses in primary aluminum production would be about \$172 million. Recognition of the non-fuel use character of the electricity and carbon used in producing primary aluminum would still require the U.S. aluminum industry to contribute over \$117 million to the federal treasury in Btu taxes.

Primary aluminum is an international commodity whose price is set on the London Metal Exchange (LME) and other major world exchanges. The increased costs of production resulting from the Btu tax cannot be passed on to customers, especially when the world price is at or below the cost of production.

Low energy cost countries like Canada, Australia, Brazil, Venezuela, Norway and the Middle East are both traditional and growing suppliers of primary aluminum. Many of those countries would be very supportive of a U.S. Btu tax because they would benefit by taxation that makes the U.S. industry less competitive. The C.I.S., particularly Russia, is a huge supplier to world markets now that the former Soviet domestic economy has not found new domestic uses for metal once used primarily by the military.

The Btu tax will severely disadvantage and jeopardize the U.S. primary aluminum industry both in the U.S. and export markets.

The U.S. aluminum industry requests that the Btu tax mechanism enacted by the Congress recognize that non-fuel uses (electricity and carbon anodes and cathodes) in the production of primary aluminum should not be covered by any such plan.

The U.S. aluminum industry supports the Administration's proposal that the Btu tax not apply to the exports of aluminum in all forms to avoid harming the industry's ability to remain competitive in world markets.

The President's Energy Tax Proposal

The President's energy tax proposal would impose an excise tax on fossil fuels (coal, oil, natural gas) at a basic rate of 25.7 cents per million Btu, with an additional tax on oil of 34.2 cents per million Btu. A tax would also be imposed on hydro and nuclear-generated electricity "at a rate equal to the national average" of the tax on electricity from fossil fuels.

The tax would be:

- o \$5.57 per ton of coal;
- o \$3.47 per barrel of oil;
- o \$.26 per 1000 cubic feet of natural gas; and
- o \$.27 per hundred KWH of hydro and nuclear-generated electricity.

In addition to its primary purpose of raising revenue, the tax has three purposes:

- o reducing environmental damage;
- o fostering energy conservation; and
- o reducing dependence on foreign sources of energy.

While the tax is described as an energy use tax, it would also provide for exemptions and downstream credits for non-fuel use and exports.

The Aluminum Reduction Process

The three key feedstocks in the chemistry of the process by which aluminum metal is produced are: anode carbon, alumina, and electricity. The electrolytic process is the only commercially proven method of producing the metal.

Aluminum does not occur in nature as metal, but rather as its oxide, alumina (Al_2O_3). Deposits of bauxite ore are mined and refined into alumina -- one of the feedstocks for aluminum metal.

Alumina and electricity (the second feedstock) are combined in a cell with a molten electrolyte called cryolite.

Direct current electricity is passed from a consumable, carbon anode into the cryolite, splitting the aluminum oxide into molten aluminum metal and oxygen. The molten aluminum collects at the bottom of the cell and is periodically "tapped" into a crucible and cast into ingots.

The process of splitting alumina into aluminum metal and oxygen consumes approximately 7 KWH per pound of aluminum produced. Continual progress has been made over the 100-year history of aluminum processing to reduce the electricity requirement. There are currently no viable alternatives to the process described above.

The electricity used in the process and the petroleum and coal derivatives used in carbon anodes and cathodes, by which aluminum metal is made from alumina (Al_2O_3), are non-fuel uses of energy.

The Impact of the Tax to the Aluminum Industry

If the Btu tax were levied on non-fuel energy uses in primary aluminum production, it would amount to production cost increases of approximately \$172 million. This translates to a 2.4 cent increase in the cost of producing a pound of aluminum (4 percent cost increase).

If the tax is applied to aluminum fabrication without recognition for the non-fuel uses of electricity and carbon, the cost of producing mill products domestically would rise by about 1.7 cents per pound. If the non-fuel uses of electricity and carbon in primary metal production are properly accounted for, the U.S. industry's cost for mill product operations would increase by about one-half a cent a pound.

This would translate into an additional \$117 million in revenues to the U.S. Treasury for energy used in manufacturing operations.

World Competitiveness

Beginning in 1982, U.S. aluminum companies began a process of restructuring to accommodate the competitive realities of the changing nature of the global aluminum economy. By 1992, the number of plants was reduced from 680 to 550, including the elimination of nine smelters representing one million metric tons (MMT) of production.

Primary aluminum is an international commodity whose price is set on the LME and other major world exchanges. Costs of production can not be passed on automatically to customers, especially when the world price is at or below the cost of production. According to Anthony Bird, a leading world aluminum analyst, the average cost of producing a pound of primary aluminum in the U.S. is more than 60 cents and the current LME price is in the 52-54 cents per pound range.

While the U.S. is the world's largest producer of primary metal (approximately 4 MMT), it is a net importer of ingot, primarily from Canada. Japan and the E.C. are also major importers of primary metal. Canada, Australia, Brazil, Venezuela and Norway have been the traditional suppliers of metal to the world. The C.I.S., particularly Russia, have in the past three years become a major exporter of metal. With the collapse of the Soviet economy, there are no domestic markets for the metal being produced in the C.I.S. and with a recession in the West, there has been no place for this metal. Many of these countries would be very supportive of a U.S. Btu tax on primary aluminum production because they would benefit by taxation that makes the U.S. industry less competitive.

What all of this means is that a U.S. Btu tax will severely disadvantage the U.S. primary aluminum industry in the U.S. and export markets (Japan now imports some metal from the U.S.).

It further means that U.S. mill products production would either rely on foreign metal or risk being undercut in the U.S. market and would be in certain jeopardy of losing export markets. Japan, the E.C., and Canada are our major trading partners.

Energy Conservation

From its inception, the U.S. aluminum industry has pursued the reduction of its use of electricity. Over time, the average amount of electricity needed to make a pound of aluminum has gone from more than 12 kWh in the 1940s to approximately 7 kWh today. These reductions are technologically based and are implemented with larger capital investments. Continued energy conservation has resulted in a 23 percent reduction since 1972 in the amount of energy required to make a pound of aluminum mill products.

An important contributor to making aluminum more energy efficient has been the growth of recycling. In 1972 secondary metal accounted for one MMT or 18 percent of the nation's total metal supply of 5.445 MMT. By 1991, secondary metal accounted for 2.5 MMT or 31 percent of the total of 8 MMT. The increased use of recycled metal is a trend which will continue.

The energy used to produce aluminum is saved for future re-use through recycling. Applications of aluminum in transportation and elsewhere significantly reduce energy and fuel use.

The aluminum air battery which has a replaceable aluminum anode and an air cathode with a flowing electrolyte has been researched as a power source for a battery operated vehicle.

Replacing heavier weight materials with one thousand pounds of aluminum on a mid-sized sedan results in a vehicle which is 25 percent lighter and 20 percent more fuel efficient. The vehicle would save 770 gallons of gasoline over its 100,000 miles of service and the metal would be recycled at the end of its service life.

Environment

U.S. aluminum producers and fabricators adhere to the most stringent environmental rules applicable anywhere in the world to aluminum manufacturers. Substitution of foreign aluminum ingot and mill products for U.S. products will result in a net loss of global environmental protection.

The 3.5 million tonnes of aluminum production in the C.I.S. is substantially without health, safety or environmental controls.

U.S. Competitiveness

In the markets in which primary aluminum and mill products compete, success or failure is based on fractions of a penny. If any U.S. materials industry is benefited by a credit or exemption for non-fuel use of energy, then all competing materials which are denied a non-fuel credit or exemption will be severely disadvantaged.

Aluminum competes directly in all of its major uses with other materials (steel, plastic, glass, etc.) which will also be requesting adjustments based on non-fuel use -- equity demands that all competing materials be treated equally by government action and that each be able to compete on the basis of inherent characteristics.

By the same token, to avoid penalizing U.S. manufacturers, exports of materials and products should be credited with tax paid on fuels used in production. Export credits must continue to be part of the President's proposal if the U.S. aluminum industry is to avoid international competitive jeopardy by reason of a U.S. Btu tax.

Conclusion

The U.S. aluminum industry supports the President's efforts to reduce the deficit, and to foster energy conservation, an improved environment and less reliance on foreign sources of energy.

The industry requests that the electricity, petroleum and coal derivatives which are essential feedstocks in producing aluminum from alumina be properly designated as non-fuel uses of energy.

Further, we support the Administration's proposal for energy credits for all aluminum exports.

**Estimated Effect of BTU Tax
On the U.S. Aluminum Industry**

| | | <u>Estimated Tax</u> | |
|---|----------------|----------------------|---------------|
| | <u>Billion</u> | | <u>With</u> |
| | <u>BTUs</u> | <u>\$000</u> | <u>Credit</u> |
| | | | <u>\$000</u> |
| Alumina (Bauxite Refining) | | | |
| Fossil Fuels | 47,250.5 | 12,202.8 | 12,212.8 |
| Electricity | 10,105.3 | 2,597.0 | 2,577.0 |
| Total | 57,355.7 | \$14,799.8 | \$14,799.8 |
| \$/lb. @ 10.0 billion pounds | | 0.0015 | 0.0015 |
| Primary Aluminum (Reduction Process) | | | |
| Fossil Fuels | 83,305.9 | 39,220.7 | 14,520.2 |
| Electricity | 674,326.6 | 177,663.0 | 30,625.3 |
| Total | 757,632.5 | \$216,883.7 | \$45,145.4 |
| \$/lb. @ 8.9 billion pounds | | 0.0244 | 0.0051 |
| Primary Aluminum (Including Alumina) | | | |
| Fossil Fuels | 130,556.4 | 51,423.5 | 26,722.9 |
| Electricity | 684,431.8 | 180,260.1 | 33,222.3 |
| Total | 814,988.2 | \$231,683.5 | \$59,945.3 |
| \$/lb. @ 8.9 billion pounds | | 0.0261 | 0.0067 |
| Aluminum Mill Products | | | |
| Fossil Fuels | 120,183.2 | 32,773.7 | 32,773.7 |
| Electricity | 90,138.6 | 24,573.2 | 24,573.2 |
| Total | 210,321.8 | \$57,346.9 | \$57,346.9 |
| \$/lb. @ 17.1 billion pounds | | 0.0033 | 0.0033 |
| <hr/> | | | |
| Total Aluminum Industry | | | |
| Fossil Fuels | 250,739.6 | 84,197.2 | 59,496.6 |
| Electricity | 774,570.4 | 204,833.2 | 57,795.5 |
| Total | 1,025,310.1 | \$289,030.4 | \$117,292.1 |
| \$/lb. @ 17.1 billion pounds | | 0.0169 | 0.0068 |

Note: (*) Excludes energy consumed by an estimated 1,000 U.S. aluminum foundries

Source: The Aluminum Association
March 12, 1993

U.S. Primary Aluminum Capacity

| Location | Company | Capacity (Metric Tons) Raided 01/01/83 | Utilized 01/31/83 | Number of employees | Type of Power | Power Company |
|--------------------------|--------------------|--|----------------------|------------------------|--------------------------------------|---|
| Pacific Northwest | | | | | | |
| Wenatchee, Wash. | Alcoa | 220,000 | 178,000 | 800 | Hydro | Bonneville Power Administration |
| Fondale, Wash. | Alumina-Alcoa | 272,000 | 204,000 | 1,786 | Hydro | Bonneville Power Administration |
| Oakdale, Wash. | Columbia Aluminum | 184,000 | 125,000 | 1,100 | Hydro | Bonneville Power Administration |
| Columbia Falls, Mt. | Columbia Falls | 168,000 | 128,000 | 881 | 80% Hydro/20% Thermal | Bonneville Power Administration |
| Mead, Wash. | Kaiser | 200,000 | 150,000 | 1,164 | Hydro | Bonneville Power Administration |
| Tecoma, Wash. | Kaiser | 74,000 | 54,000 | 376 | Hydro | Bonneville Power Administration |
| The Dalles, Ore. | Northwest | 82,000 | 71,000 | 487 | Hydro | Bonneville Power Administration |
| Longview, Wash. | Reynolds | 204,000 | 204,000 | 828 | Hydro | Bonneville Power Administration |
| Trousdale, Ore. | Reynolds | 121,000 | Isided | 805 | Hydro | Bonneville Power Administration |
| Vancouver, Wash. | Vancouver | 115,000 | 115,000 | 676 | Hydro | Bonneville Power Administration |
| Total Pacific Northwest | | 1,624,000 | 1,229,000 | 8,808 | 86% Hydro/2% Coal | Bonneville Power Administration |
| Ohio Valley | | | | | | |
| Bethree, Ky. | Alcan | 180,000 | 180,000 | 750 | Thermal, Coal | Big River Power |
| New Madrid, Mo. | Noranda | 215,000 | 215,000 | 1,185 | Thermal, Coal | Elec Co-op of Springfield |
| Warrick, Ind. | Alcoa | 300,000 | 300,000 | 1,886 | Thermal, Coal | Southern Ind. Gas & Elec & Alcoa Generating Corp. |
| Hannibal, Ohio | Ormet | 250,000 | 250,000 | 1,500 | Thermal, Coal | Ohio Power Co. |
| Riverswood, W.Va. | Riverswood | 185,000 | 185,000 | 888 | Thermal, Coal | Ohio Power Co. |
| Hausville, Ky. | Southside | 185,000 | 185,000 | 700 | Thermal, Coal | Green River Rural Electric |
| Total Ohio Valley | | 1,295,000 | 1,295,000 | 8,883 | 100% Coal | |
| Other | | | | | | |
| Bedin, N.C. | Alcoa | 115,000 | 115,000 | 650 | 80% Hydro/40% Thermal Coal & Nuclear | Alcoa Generating & Duke Power Co. |
| Alcoa, Tenn. | Alcoa | 206,000 | 206,000 | 1,350 | 20% Hydro/80% Thermal Coal | Alcoa Sub of Tapoco & TVA |
| Massena, N.Y. | Alcoa | 125,000 | 125,000 | 1,500 | 50% Hydro/50% Thermal Nuclear | Power Authority of N.Y. |
| Rockdale, Texas | Alcoa | 315,000 | 315,000 | 1,600 | Thermal, Lignite | TX Power & Light/Alcoa |
| Frederick, Md. | Alumina - Enstatco | 174,000 | 174,000 | 1,142 | Thermal, Coal | Potomac Edison & Allegany Power |
| Mount Holly, S.C. | Alumina, Inc. | 182,000 | 145,800 | 1,146 | Thermal, Coal | South Carolina Public Service |
| Massena, N.Y. | Reynolds | 123,000 | 123,000 | 720 | 85% Hydro/6% Thermal Nuclear | Power Authority of N.Y. |
| Total Other | | 1,238,000 | 1,202,800 | 8,157 | 66% Coal/23% Hydro/7% Nuclear | |
| Total U.S. | | 4,158,000 | 3,728,800 | 24,046 | 63% Coal/45% Hydro/2% Nuclear | |
| Percent Operating Rate | | | 89.6% | | | |

Source: Primary Aluminum Plants Worldwide, U.S. Bureau of Mines, 1986
 Aluminum Input Capacity, American Metal Market, January 1983
 Aluminum Association Surveys

The Aluminum Association, Inc. - March 12, 1983

STATEMENT OF THE AMERICAN ASSOCIATION OF EXPORTS AND IMPORTS

Introduction

AAEI is a national organization of approximately 1,200 U.S. firms active in importing and exporting a broad range of products including chemicals, machinery, electronics, footwear, foodstuffs, textiles and apparel. The Association's members also include customs brokers, freight forwarders, banks, attorneys and insurance carriers.

AAEI appreciates the opportunity to comment on the President's request for an extension of Fast Track procedures for Uruguay Round implementation and extension of the U.S. Generalized System of Preferences (GSP) as provided for in the Budget Reconciliation Act of 1993 (H.R. 1960).

The General Agreement on Tariffs and Trade (GATT) Uruguay Round Multilateral Trade Negotiations, which started in 1986, involves over 100 nations worldwide. The United States and many of our trading partners have been extremely frustrated and disappointed over the failure to complete the Round to date. A successful completion to the Uruguay Round would establish new multilateral rules for world trade, lower tariff and non-tariff barriers to trade, and provide a better international dispute settlement mechanism. It would be the most important step toward opening foreign markets to trade with the U.S. For these reasons, AAEI strongly endorses President Clinton's proposal to seek renewal of Fast Track negotiating authority for the Uruguay Round beyond the current May 31, 1993 expiration date. This would entitle the President to notify Congress no later than December 15, 1993 of his intention to enter into a final agreement before April 15, 1994. Seeking renewal of Fast Track represents the seriousness of the Administration's commitment to reach a successful conclusion to the Round.

AAEI would also like to address the need to renew the GSP program which is due to expire on July 4, 1993. For twenty years, GSP has given developing countries access to the world marketplace by allowing exportation to industrialized countries free of duty. Its philosophy of trade, rather than aid, is a more effective, cost-efficient means of promoting sustained economic development. Thus, AAEI has consistently supported a strong GSP program and continues to do so. The imminent expiration of the GSP program is of great concern to AAEI and its members. It is difficult to plan an import strategy with the knowledge that a program on which you rely is going to expire on July 3 of this year.

AAEI has some suggestions for improving the GSP so it would provide more security for traders and enhance benefits for American producers. However, in view of the short time period remaining in the current GSP program, there is not enough time to fully consider and analyze any modifications. Therefore, we support U.S. Trade Representative Mickey Kantor's call for a fifteen month extension of the GSP program through September 30, 1994, with eligibility added for states formerly part of the Soviet Union. This would allow time for the Administration and the new Congress to consider the long term shaping of the program in light of developments in the Uruguay Round, NAFTA, and the Enterprise for the Americas.

Successful Completion of the Uruguay Round is Crucial for World Trade

A successful conclusion to the ongoing Uruguay Round is critical for the elimination of U.S. trade barriers and barriers facing the exportation of U.S. goods and services. Reduction of these barriers is necessary to promote the national trade interests of the U.S. as well as the interests of the business community, consumers, and workers. Trade barriers drain our nation's economy of billions of dollars annually, force consumers to pay much higher prices for goods, and increase costs of production for U.S. industry.

The most harmful trade barriers to U.S. business and consumers are non-tariff measures, particularly quotas and voluntary restraint agreements. Tariffs, the most transparent form of trade barrier, are also harmful to U.S. industry. Domestic businesses suffer a loss of international competitiveness, and the U.S. consumer bears the ultimate burden of trade barriers due to increased costs of manufacturing with imported components created by high tariffs. A successful conclusion to the Uruguay Round will provide a worldwide opportunity for the lowering or elimination of non-tariff and tariff barriers from which the U.S. and its industry will greatly benefit.

Since a successful conclusion to the Uruguay Round has not yet been reached, extension of Fast Track is a pressing issue. Fast Track negotiating authority must be renewed. AAEI strongly supports President Clinton's proposal for extension of Fast Track, for delay will cause increasing complexity of the Uruguay Round. Absence of Fast Track negotiating authority will create reluctance among U.S. GATT partners to reach an agreement with our Administration because it may be necessary to renegotiate with Congress issues which have already been settled. For these reasons, extension of Fast Track authority which will enable a successful conclusion of the Uruguay Round is crucial.

AAEI Supports Renewal of the Generalized System of Preferences

AAEI urges Congress to renew the U.S. Generalized System of Preferences (GSP) which is due to expire on July 3, 1993. For twenty years, GSP has given developing countries access to the world marketplace by allowing them to export many products to industrialized countries free of duty. GSP is based on a philosophy of trade, rather than aid, as a more effective, cost-efficient means of promoting sustained economic development.

The imminent expiration of the GSP program is of great concern to importers. Over twenty other industrialized countries have adopted the GSP concept and continue to import goods duty-free from developing countries. The United States must continue this program in order to remain competitive in international trade and to foster development in the Third World.

AAEI has been an active participant in the debates surrounding the renewal of GSP for many years which resulted in the Trade and Tariff Act of 1984. AAEI's educational efforts were instrumental in several improvements to the program.

AAEI supports the current Presidential authority to waive statutory limits on a particular GSP import from any beneficiary country if he receives advice from the International Trade Commission (ITC) on whether any industry is likely to be adversely affected by such a waiver, and he determines that such a waiver is in the national economic interest of the United States. [19 U.S.C. 2464(c)(3)(A)]. This general waiver of authority has allowed the Administration to conduct the review process in an intelligent manner, without subjecting the flow of trade to otherwise potentially disruptive automatic mechanisms which would deny duty-free benefits to products needed for U.S. domestic production.

The Annual review process has also enabled the U.S. to use the waiver for gaining leverage in negotiations to assure market and commodity access and to enforce intellectual property rights. [19 U.S.C. 2464(c)(3)(B)]. Most recently, the former Administration has employed denial of the waiver to enforce patent rights on pharmaceuticals and chemicals which are allegedly violated by manufacturers in India. [Presidential Proclamation 6425; 57 Fed. Reg. 19067].

AAEI believes the review process should be conducted only once every two years to cut costs. Limiting the examination process would also assist importers in making difficult long-range sourcing decisions regarding where to acquire needed materials, enabling U.S. companies with business dealings in developing countries to maintain a competitive edge.

One argument against renewal of GSP involves environmental concerns. AAEI is strongly opposed to using an environmental standard as a criterion for granting or maintaining a country's GSP beneficiary status. Legislation in this direction has been introduced in the past and has not met with success. Requirement of an environmental standard would only weaken the GSP program. Imposition of an environmental standard would be a unilateral action on an issue which should be addressed multilaterally. Such standards generally penalize U.S. importers, manufacturers and consumers by disallowing duty-free entry from the offending country. The result is diminution of U.S. competitiveness by strengthening the position of other GSP-granting countries who have no such standard.

Assuming GSP is renewed, and there is time for thorough consideration of the GSP program next year, AAEI looks forward to a redefinition of rules of origin. The existing rules of origin require eligible articles to be imported directly from the beneficiary country to the U.S. The sum of the cost or value of the materials produced in that country plus the direct costs of processing operations performed must be at least thirty-five percent of appraised value upon entry into the United States. [19 U.S.C. 2463(b)(1)].

AAEI proposes allowing U.S. component input to count toward the 35% minimum value rule for GSP. While mandating U.S. value content input would thwart the express purpose of GSP, allowing such input to count toward the 35% would be a boon to U.S. domestic manufacturers, importers and consumers. It should be noted that a similar allowance is made by other countries including Japan and Canada. Other trade programs which allow a donor country content rule include the Caribbean Basin Initiative Act. [19 U.S.C. 2702].

AAEI not only supports renewal of GSP, but believes the U.S. should seek to expand the GSP program by granting duty-free beneficiary status to more countries in Eastern Europe. Russia is currently excluded from receiving GSP benefits as a successor state to the Soviet Union. [19 U.S.C. 2462(b)]. After President Clinton's Summit Conference with Russia's President Boris Yeltsin in Vancouver, Canada earlier this month, the Administration announced its proposal to eliminate its legal exclusion from GSP, and to extend GSP to Russia. In 1992, Russia shipped \$46 million to the United States in GSP eligible goods. Based on previous experience, this volume would increase if preferential status is granted. In this case the purpose of the GSP program would be well-served, insofar as trade is better than aid. AAEI supports the President in his efforts to extend the benefits of the GSP to Russia. We also support granting GSP beneficiary status to other countries which now make up the Confederation of Independent States, such as Ukraine, Belarus and others.

Strengthening of American competitiveness abroad necessitates GSP renewal since well over twenty other industrialized countries grant duty-free benefits to developing countries. Because a considerable amount of duty-free goods are being used as components in U.S. manufacturing, loss of GSP would be a severe blow to these sectors of the U.S. economy as well as to the economies of developing nations.

The aforementioned changes would enhance realization of the purpose of the GSP program, benefitting not only developing countries, but also U.S. economic interests. AAEI urges extension of the GSP

program for a fifteen month period through September 30, 1994, as has been suggested by U.S. Trade Representative, Mickey Kantor.

Conclusion

AAEI strongly supports President Clinton's proposal to renew Fast Track negotiating authority for the Uruguay Round as we believe it is necessary for successful completion of the Round.

The Association also supports renewal of GSP for at least fifteen months. The GSP program has historically encouraged trade with underdeveloped nations and led to substantial economic gains for both these countries and the United States.

These issues should be considered in light of their importance to the United States and the international trade community.

STATEMENT OF THE AMERICAN FARM BUREAU FEDERATION

We appreciate the Committee's efforts to focus the nation's attention on our serious budget and economic problems. Clearly, difficult choices will be required to effect corrective measures that will bring the deficit under control and provide responsible prioritization of spending and tax policy for the nation. The cost of failure will be diminishing standards of living for our citizens, loss of competitiveness in the world economy, and a legacy of debt and despair for future generations. The American Farm Bureau Federation (AFBF) has strongly supported policies to strengthen the economic foundation of our nation, and we stand ready to work with the Congress and the administration to get the job done.

However, Farm Bureau is compelled to express our members' deep concern about the energy tax proposal in the President's economic package. If imposed, this tax will stifle economic output, increase production costs for farmers, cause farm prices to decline and jeopardize our ability to compete in world markets. When agricultural products are processed, packaged and transported to consumers, they will be more costly due to the multiplier effect of energy cost increases at each point in the food distribution chain.

Energy taxes will affect all rural Americans, who by definition live in relatively remote and less populated areas. The cost of driving more miles to work, shop, send children to school, and to conduct a variety of other normal activities will be immediately felt by a segment of the population which tends to have lower than average income. Increased costs for home heating and electricity also will be borne by rural Americans. The energy tax will disproportionately increase the cost of living for 65 million rural people.

Agricultural production is highly energy-dependent. Farmers rely on gasoline, diesel, propane and other fuels for operating equipment such as tractors, combines and trucks. They also use energy for grain drying, greenhouses for horticultural crops, and have cooling tanks and storage facilities that require energy to operate. Farmers rely on electricity, gas and petroleum fuels for energy to operate irrigation systems. These direct uses of energy will increase farmers' costs by an estimated \$500 million per year when the proposed energy tax is fully implemented.

In addition to the direct use of energy on the farm, many of the inputs crucial to agricultural production also are highly energy-dependent. The costs for fertilizer and pesticides will increase. Our analyses indicate that farmers will pay another \$500 million per year in increased costs of purchased inputs due to the

energy tax. Therefore, the direct and indirect production cost increases will amount to an estimated \$1 billion per year.

An example of an increase in indirect costs would be the impact on fertilizer. It takes approximately 34,500 cubic feet of natural gas to produce one ton of anhydrous ammonia fertilizer. The cost of producing a ton of anhydrous ammonia will increase approximately \$9 per ton. However, there are other factors at work. The proposed energy tax will increase transportation costs to move the ammonia from the manufacturing plant to the farm. A significant portion of anhydrous ammonia, as well as other fertilizers, utilized by farmers is shipped via barge. Consequently, the increased inland waterways tax will add another \$3 per ton to fertilizer prices. Net delivered costs of anhydrous ammonia fertilizers to the farm will probably increase between \$10 to \$15 per ton when all the incremental cost increases are included. This is equivalent to a 5 percent to 6 percent increase in anhydrous ammonia prices.

Since farmers are typically marketers of undifferentiated bulk commodities, they are price takers in the market place. Therefore, there is virtually no way to pass on these increased costs for the vast majority of agricultural products.

Another disturbing effect of the energy tax proposal is that it will likely result in lower farm prices in addition to higher production expenses. Farm prices are generally established in markets that reflect national and international demand. Market prices are established through the price discovery system at centralized locations such as the coastal and Gulf ports. Farm prices reflect the international market prices minus the transportation and handling costs associated with moving the goods to centralized markets. Since the energy tax will increase marketing and transportation costs, farm prices will tend to decline to offset these margins. As a result, farm profits will be squeezed by increases in production costs and declining market prices.

This situation will be further exacerbated if the inland waterway fuel tax is increased from the current \$.19 to \$1.19 per gallon. This exorbitant increase in the tax, 525 percent, will increase shipping costs for an efficient and environmentally responsible method of transporting agricultural commodities and other goods. For example, barging costs for corn and soybeans being shipped from the Midwest to New Orleans will be increased 7 cents per bushel. When fully implemented it will add \$150 million to grain and oilseed barge transportation costs. We believe this additional tax would prove to be especially detrimental to U.S. agricultural products in the highly competitive world market and, therefore, to farmers and ranchers on a national level, grain and oilseed prices will be reduced approximately 2 cents per bushel.

There is one other aspect of the proposed energy tax that has received relatively little attention. The energy tax plan includes the cancellation of the September 30, 1995, expiration of an increased fuel excise tax enacted as part of the Omnibus Budget Reconciliation Act of 1990. The net impact is to increase farmer fuel costs another 2.5 cents per gallon. Therefore, starting in 1996 anywhere from one-fourth to one-third more can be added to the above examples to ascertain the total impact of the proposed energy tax.

Finally, it needs to be stressed that the above cost estimates are for the farm business operation only. These do not include the higher costs of fuels related to personal transportation, nor do they include the costs related to either shipping food and fiber from the farm to the consumer or the transportation costs associated with purchasing supply inputs. Past studies have shown that the amount of energy utilized for these purposes is equivalent to somewhere between one-third and one-half all the energy utilized directly in the farming operation.

Impact on the General Economy

Although this BTU tax on gasoline is estimated at 7.5 cents per gallon, we believe the impact would be proportional to an analysis¹ by the Institute for Research on the Economic of Taxation that a 10 cent increase in the gasoline excise tax would cost the American economy more than \$23 billion in lost GNP in the near term. Productivity would advance more slowly, and real wage rates and employment levels would be lower than otherwise. The tax hike would result in 232,000 fewer full-time equivalent jobs in the first full year. In the year 2000, GNP, in constant 1990 dollars, would be \$26.6 billion less than if the tax were not increased, and employment would be off by 247,000 jobs compared to the level of employment without the tax hike.

We believe that agriculture will be particularly hard hit by the proposed energy tax. Attached is information that Farm Bureau has compiled to illustrate examples of its direct impact on agriculture. Please remember that these numbers reflect only increases in production costs and do not include additional expenses for personal energy consumption (e.g. home heating, shopping, schools and traveling to and from off-farm jobs).

Farm Bureau urges you to reject the energy tax because of its negative impact on efficiency, productivity and competitiveness.

Instead, Farm Bureau supports a spending freeze in all federal programs as a viable alternative to a deficit reduction plan which relies heavily on tax increases.

Thank you for consideration of Farm Bureau's comments.

Attachment

¹ "The Impact, Shifting, And Incidence of an Increase in the Gasoline Excise Tax," Institute for Research on the Economics of Taxation (IRET), 1992.

FUEL**TAX RATE**
(cents per gallon)

| | |
|--------------|-----|
| Gasoline | 7.5 |
| Diesel | 8.3 |
| Propane (LP) | 2.3 |

Examples of the Proposed Energy Taxes' Impact on Farmers (Increased Direct Energy Costs)

The examples listed for California illustrate fuel energy costs based on figures extracted from various University of California Cooperative Extension (UCCE) reports entitled "Sample Costs of Production." It is important to note is that these costs reflect fuel usage for tractors and harvesting equipment only. Fuel used to power irrigation pumps is not included here but can be a significant expense in some areas.

CALIFORNIA:

| | |
|--|---------|
| • 400 acres for rice production—Sacramento Valley | \$996 |
| • 1,200 acre farm with 500 acres of cotton—San Joaquin Valley | \$1,660 |
| • 1,200 acre farm with 600 acres in tomato production—San Joaquin Valley | \$3,486 |
| • 1,200 acre farm with 200 acres in broccoli production—San Joaquin Valley | \$830 |

The information for the following example was compiled by our research economist from information supplied by the respective state Farm Bureaus. The data reflects typical farm operations as defined in each example. In all cases, farmers were asked to indicate the amount of fuel that was actually utilized in their operation. The gallons involved were then multiplied by the proposed energy tax rates shown in the shaded box above:

ILLINOIS:

| | |
|---|-------|
| • 500 acres of row crop (mostly corn); no livestock | \$670 |
|---|-------|

IOWA:

| | |
|---|-------|
| • 486 acres of row crop; 800 head of market hogs; 100 head of cattle | \$723 |
| • 721 acres of row crop | \$513 |
| • 10,000 head/year for hog farrowing operation; 4,500 head finished on site | \$529 |

KANSAS:

| | |
|--|---------|
| • 2,100 acres of corn, soybeans, milo and wheat; no livestock | \$1,513 |
| • 3,000 acres of one-third-irrigated corn, wheat and alfalfa; two-thirds-dryland wheat and milo; 200 cattle feeding | \$2,816 |

NEBRASKA:

| | |
|---|---------|
| • 500 acres of mostly corn, two-thirds-irrigated; 80 cow-calf operation | \$1,593 |
| • 260 acres of one-half-irrigated corn and alfalfa; 250 head beef finishing operation | \$715 |
| • 2,700 acres of summer fallow wheat; no livestock | \$1,020 |
| • 800 acres of irrigated corn and soybeans; no livestock | \$1,624 |

NEW JERSEY:

| | |
|--------------------------------|---------|
| • Greenhouse/nursery operation | \$1,469 |
|--------------------------------|---------|

TEXAS:

| | |
|--|---------|
| • 1,300 acres of one-fourth-irrigated cotton and wheat | \$2,650 |
|--|---------|

WASHINGTON:

| | |
|---|---------|
| • 80,000 square feet greenhouse producing cut flowers and potted plants | \$3,397 |
|---|---------|

WISCONSIN:

| | |
|---|-------|
| • 200 acres of corn and dairy; 50-cow dairy operation | \$170 |
|---|-------|

STATEMENT OF THE AMERICAN FOREST AND PAPER ASSOCIATION

The American Forest and Paper Association (AFPA) is the national trade association of the forest products industry representing producers of paper, pulp, paperboard and wood products, as well as the growers and harvesters of this Nation's forest resources. The industry has over \$200 billion in total shipments, 1.4 million workers, and operates in every State in the Union. Forest products represents more than seven percent of U.S. manufacturing output, and the industry is among the top ten employers in 46 States with an annual payroll of \$44 billion.

The forest products industry is perhaps unique among American manufacturers in that not only is the industry a major purchaser and user of energy, but it also is one of the most energy self sufficient industries in the United States.

The forest products industry, in total, purchases over \$7 billion in fuel each year (\$5.5 billion for pulp, paper and paperboard; \$1.5 billion for wood products). Yet, at the same time, the industry provides approximately 60 percent of its annual energy needs through the use of non-traditional biomass fuels — bark, wood waste and pulping residues. And the industry is proud that its use of non-traditional fuels has increased by nearly 50 percent per ton of product over the past twenty years.

The forest products industry realizes that some higher taxes may be necessary as part of a balanced economic package. We will not oppose the entire package nor the BTU tax simply because it increases taxes. We are concerned, however, that insufficient attention has been directed at solving the problems of energy intensive manufacturers competing in the international market place.

Because the forest products industry is one of the largest industrial purchasers of energy, the BTU tax as proposed by the Clinton Administration will be especially burdensome on paper and wood products competing in markets throughout the world against products manufactured in other countries. The proposed BTU tax will merely increase U.S. manufacturing costs — costs that cannot be passed on and must be absorbed, since prices on most paper and wood products are set globally.

Exports are critical to the future growth of the forest products industry. In 1992 exports totaled approximately \$1.5 billion, and there was a positive balance of trade in both paper and wood products. Approximately 60 percent of the paper industry's growth during the 1987-92 time period has been in export markets, and the industry projects additional increases in exports during the coming years. However, the ability to increase or maintain current levels of export could be jeopardized if costs are increased due to a BTU tax.

The BTU tax will fall disproportionately on the most energy-intensive sectors of the economy such as pulp and paper manufacturing. For some paper product lines, manufacturing costs are expected to increase by approximately two percent. The impact on these products is 20 times greater than the average impact estimated by the Treasury Department.

In fact, U.S. producers of pulp and paper now pay higher costs for energy than in most of the other nations with major paper industries. Many of our primary competitors have low-cost and/or federally subsidized electricity (Sweden, Finland, Canada). The proposed energy tax will only serve to exacerbate that difference and hinder American concerns in their ability to compete.

In addition, many nations provide full or partial tax exemptions from various energy taxes for manufacturing industries. The proposed carbon tax for nations in the European Community allows reductions for industries in which energy represents over

eight percent of the value added (for primary pulp and paper mills, energy represents 11.4 percent of the manufacturing cost). Sweden recently repealed its energy tax on industrial use as part of an economic growth and international competitiveness program.

For manufacturing industries, the BTU tax serves only to increase the costs of production. Industries such as forest products that now compete in a world-wide marketplace would be disadvantaged. While the BTU tax proposed by the Administration will probably achieve its stated goal of raising revenue, it will be only at the expense of American exports and, eventually, at the expense of American jobs.

Despite the industry's misgivings about the BTU tax, we commend the Administration and Congress for recognizing the environmental and energy security role for non-fossil fuels which will be encouraged by the biomass exemption. The forest product industry's record of energy self-sufficiency as stated above -- providing 60 percent of our own energy needs -- is due almost entirely to developing and utilizing new equipment and technologies so that bark, wood waste, and spent pulping residues can be recovered and again in a constructive, energy-efficient manner. By reducing fossil fuel and purchased energy consumption by 46 percent per ton of product since 1972, the forest products industry effects the annual saving of an equivalent of more than 230 million barrels of oil (about 31 days of imports at today's level).

Use of non-traditional fuels such as biomass is in the national interest. Without biomass, the forest products industry would use more conventional, pollution-causing fossil fuels, and given the location of many mills in New England, much of it imported oil. Furthermore using these unavoidable wood wastes as a fuel eliminates the need for other less desirable methods of disposal such as landfills.

In conclusion, any energy tax proposal should not impede the ability of American business to compete in world markets, and at the same time it should encourage conservation and the efficient use of non-traditional fuel sources. The forest products industry would urge that Congress thoroughly study the overall impact of any energy tax on international competitiveness of U.S. manufacturers and explore alternative means of raising similar amounts of revenue from other sources that would be less injurious to domestically produced products. Should an energy tax be enacted, an exemption for non-traditional fuels, such as biomass, as proposed by President Clinton, should be adopted to further our nation's environmental and energy security goals.

STATEMENT OF THE AMERICAN GAS ASSOCIATION

I. INTRODUCTION AND SUMMARY

The American Gas Association (A.G.A.) is a national trade association comprising approximately 250 natural gas distribution and transmission companies located throughout the United States. Collectively, 90 percent of the gas consumers in this country are served by A.G.A.'s members. A.G.A. welcomes this opportunity to present its views concerning the Administration's proposed energy tax.

A.G.A. commends the President in putting forth a plan for reducing the deficit, curtailing federal spending and strengthening the economy. We are encouraged by the Administration's expressed desire for greater use of clean-burning natural gas. This increased reliance on natural gas will improve our environment and domestic security and create jobs. However, these goals cannot be met if there are not healthy and growing companies in all segments of the natural gas industry.

We believe a broad-based energy tax would not accomplish these national goals of a clean environment, growth and domestic security. For a number of reasons,

A.G.A. is opposed to all broad-based energy taxes for the purpose of reducing the deficit or raising additional federal revenue for new programs. We believe broad-based energy taxes are regressive, regionally inequitable, difficult to implement, inflationary, harmful to the domestic economy, job growth and the global competitiveness of U.S. industries. When the Btu tax was initially conceptualized, there was some thought that it could promote energy security and environmental goals. As the tax developed and exemptions and changes were proposed, the environmental and energy security goals appear to have been lost. In some applications, the tax would work against these goals. We therefore urge Congress to work with the Administration in cutting federal expenditures before any new taxes are enacted.

If it is determined that additional taxes are necessary to reduce the deficit, we urge you to seriously consider implementing a national consumption tax, rather than a tax exclusively on energy consumption. This strategy would not harm selected industries such as manufacturing that are heavily dependent on energy. However, A.G.A. is concerned that the Administration is considering a value-added tax (VAT) on top of a Btu tax on energy as a way to fund health-care reform. If a Btu tax is imposed on energy along with a VAT, an increase in the corporate income tax rate and curtailment of other tax incentives, energy industries, such as natural gas, and their customers would be hurt disproportionately to other industries. If some form of a VAT is adopted, there should not be an energy tax as well. If both Btu and value-added taxes are adopted, the Btu tax should be phased out once the VAT is phased in.

If the Administration and Congress elect some form of an energy tax, A.G.A. believes that an increase in the federal excise tax on gasoline and/or oil import fee are the most appropriate means for raising revenue efficiently, improving the environment, encouraging domestic production and promoting energy conservation. A phased in gasoline excise tax increase of 3 cents starting in January 1994 elevating to 22 cents in 1996 would raise the same amount of revenue as proposed in the Administration's Btu tax.

If an energy tax on natural gas is inevitable, A.G.A. is united with all segments of the natural gas industry in encouraging that it be an excise tax paid by the ultimate consumer or end-user and collected by the entity selling the gas to the consumer in a manner similar to the federal excise tax on telephone service. The Administration's proposal to collect the tax on natural gas at the city-gate or "out of the pipeline" threatens the well-being of gas companies, particularly gas utilities which may be denied full and immediate flow through of the tax. The Btu tax could equal or exceed the annual net income of a majority of A.G.A. member companies. This impact on utilities would also adversely affect every other segment of the natural gas industry and customers. Further, collecting the tax upstream from the retail level will increase the burden in some states by as much as 15 percent because of piggyback taxes such as gross receipts and sales taxes. This cost would be in addition to the \$310 we estimate the average household would incur because of the Btu tax on energy. A.G.A. estimates these taxes could cost natural gas consumers \$350 to \$400 million annually and gas and electricity customers combined \$1 billion to \$1.2 billion annually once the tax is phased in.

The city-gate point of collection may slow the deployment of clean, efficient and domestically manufactured energy technologies, since companies that have historically marketed these technologies might not obtain effective and full flow through of the costs. Contrary to the perception of some, the tax will not increase gas markets. Among other things, natural gas would lose market share to electricity and renewables, such as wood chips, in industrial and commercial applications.

If Congress and Administration impose a Btu tax on natural gas, we urge that its collection be at the end-user level to best address a number of problems that would occur if the tax is imposed at some other location, such as the wellhead, pipeline or city-gate. First, collection of the tax at the end-user level would provide an administratively simple collection process with minimal collection points and minimize market distortions. Second, it would reduce the ultimate costs to consumers by avoiding the piggyback tax-on tax. Third, the end-user collection point best achieves the Administration's goal of flowing through the tax to end-users and reducing the gas company's exposure to absorbing the tax. Therefore, it is vitally important that the Btu tax be structured so that it is not a tax on the production, transmission or distribution of gas, but on the consumption of gas by the end-user.

While some in Congress may be reluctant to see the Btu tax appear on the customer's bill as an excise tax, some state public utility commissions (PUCs) will require disclosure regardless of where or how the tax is collected. Further, gas company CEOs advise us, for prudent business purposes, that they will inform their customers of the tax to explain the reason behind the increase in the customers'

bills. In addition, resulting ratecases will bring greater public and media attention to the tax.

A.G.A. believes all alternative transportation fuels should be treated the same or distortions will occur in the alternative fuels market. If methanol and ethanol used as an alternative fuel are exempt, then vehicular compressed natural gas should also be exempt.

City-Gate Collection Point

If the tax is collected at the city-gate, three factors should be addressed. First, gas utilities should be required to pay to the pipeline for remittance to Treasury only what they collect from the end-user.

Second, utilities should be permitted to recover the tax in customer rates. This will require some legislation directing state PUCs to allow utilities to flow through the tax. The Administration has proposed that a utility be denied its tax benefits under normalization if the energy tax is not passed through. Our concern is that this mechanism is neither a sufficient nor fair way of encouraging state PUCs to flow through the tax, since the size of the tax could exceed the benefits gained from normalization. In addition, the utility could be penalized twice under this proposal, once in the absorption of the tax and again in the denial of normalization benefits.

Third, we urge Congress to add legislative language to address the problem of double taxation or compounding of taxes. Such language should provide that revenue from recoupment of the Btu tax is excluded from any form of federal, state, local or other taxation.

II. IMPACT OF THE TAX

1. Households

For the average gas-heated household, A.G.A. estimates the tax would eventually add \$25 to the annual bill, roughly \$23 to the electric bill. The average household would also pay an additional \$76 annually on gasoline consumption. We estimate that the total average household energy costs for a natural gas heated home would rise by \$124 per year. An additional \$184 in increased annual costs per household would be hidden in the costs of all goods and services that rely on energy as they are made or delivered. We estimate that the total average household cost would be nearly \$310 per year. Larger households would pay even more.

Moreover, the national average numbers hide the higher effects upon particular regions, especially the northern states with colder winters. According to the Department of Energy, cold weather regions use as much as 55 percent more energy in homes than warm regions. In colder regions, such as Chicago, the tax would add \$38 to \$44 to a typical gas bill, rather than the \$25 national average.

2. Utilities

If portions of this tax fell upon natural gas companies because of the collection mechanism, the damage could be significant. Some utilities might have to borrow money to replace funds that would otherwise be used as working capital to pay the tax during the period the utility seek to have the tax included in consumer rates by the state PUC (regulatory lag period). Other companies may be required to absorb portions of the tax, which could cripple operations. This could cause a reduction in capital spending. Given the importance of utility capital spending to the economy as a whole, such a reduction could impede economic recovery. Further, an increase in rates to satisfy reducing the magnitude of the tax is so large that it might not receive approval for flow through in a state ratecase.

3. Consumers

The short-term retail price effects of the Btu tax after phase-in are illustrated in the attached Appendix. That chart shows the percentage increase in prices of the energy sources as a result of the tax. For example, the chart illustrates that the proposed tax raises the price in the residential sector by 4.7 percent for natural gas and 4.1 percent for electricity. The proposed tax would raise the price of gas industrial customers by 11 percent while raising that of industrial electric customers by 6.9 percent. The market effect is that the tax would have a greater impact on the prices of industrial customers.

III. THE PROBLEMS OF BROAD-BASED ENERGY TAXES

The Btu-based energy tax that is part of the proposed economic package will be, at a minimum, highly complex and very difficult to fashion in a manner that avoids serious administrative, financial, economic, regulatory and operational burdens. First, it is short-sighted to permit the current need for additional revenues or demands for deficit reduction to dictate energy policy when a sound energy plan is

central to promoting national goals of reducing dependency on foreign oil, improving exports, developing domestic infrastructure and creating jobs. The production, delivery and consumption of energy in our country is essential to meeting these national goals and to stimulating economic growth. The complexities of energy markets require consistent strategies with respect to energy, environmental and economic policies. The consideration of these issues must not be held hostage to a budget crisis.

The proposed Btu tax is in general regressive. Low-income households spend as much as four times the percentage of their income on energy as more affluent households. Therefore, a broad-based energy tax would have a disproportionate effect upon lower income households. The tax would be felt by consumers using household essentials, such as heating, cooking and water heating. Unlike a proposed "sin" tax on alcohol and tobacco, energy is a basic necessity. Reducing energy consumption can entail large expenditures (i.e., new furnace, replacing windows), which are often not affordable by lower income households. These households would need a tax credit to reduce the burden of a broad-based energy tax, or forego certain essentials.

A Btu tax like that proposed could erode U.S. competitiveness and increase inflation. An energy tax would raise the price of U.S. products in relation to foreign products, resulting in fewer exports and more imports. By taxing energy used in the production of U.S. products, domestic products would become far less competitive than foreign products in world markets. The U.S. would import more finished goods because these products would be made relatively cheaper since the energy used in the foreign manufacture of the product escapes the tax. Domestic companies could be forced to export jobs to remain competitive. Moreover, a broad-based energy tax could increase the cost of domestic manufacturers and reduce their ability to compete with foreign manufacturers in the domestic and world markets. This is hardly consistent with desirable trade policy.

Basic manufacturing industries would be particularly hard hit since they consume relatively large amounts of energy per unit of production. These industries, concentrated in the Midwest, South and Southwest, will already be faced with higher costs resulting from implementing provisions of the "Clean Air Act Amendments."

The broad-based energy tax can be inequitable on a regional basis. Generally, energy consumption in colder climates is larger than in warmer climates. Thus, taxes on energy consumption would fall disproportionately on colder regions like the upper Midwest and Northeast. Many of these areas have already been hit hard by the loss of manufacturing jobs.

A flat BTU tax, as that proposed, may favor the use of electricity over natural gas in some applications. For instance, in the generation of electricity, approximately two-thirds of the input fuel BTU value is lost due to inefficiencies in generation and transmission. A BTU tax at the retail level could, therefore, penalize customers who heat directly with gas where efficiency levels approaching 90 percent can be achieved.

IV. END-USER COLLECTION POINT

Of major concern to our industry is the point of collection for any Btu tax which might be enacted. We urge Congress to structure such a tax as a retail excise tax to be paid by the ultimate customer or end-user (last sale) and collected by the entity (i.e. utility, pipeline or other supplier) selling gas to that customer. Collecting the tax at the end-user level would minimize or eliminate many of the problems associated with the Btu tax. The end-user collection point: 1) provides an administratively simple collection process and minimizes tax avoidance; 2) reduces the administrative burden upon the industry and government, particularly in complexities occurring upstream of the retail level, such as piggyback taxes, administration of non-fuel exemptions and timing problems associated with taxing gas in storage; 3) maximizes the flow through of tax costs to consumers and eliminates regulatory approval which could expose gas companies to a regulatory lag problem; and, 4) promotes other governmental goals and policies.

A. Ease and Simplicity in Collection of Tax

A retail-level tax on gas delivered to the ultimate consumer is the most appropriate collection point option that provides an administratively simple collection process and minimizes tax avoidance. In responding to a question why the Administration chose the city-gate as the incidence for the tax, Treasury Secretary Lloyd Bentsen emphasized the city-gate collection point would eliminate 60 million taxpayers.¹ If the objective of the Administration is to facilitate ease in collection of

¹ Hearings to Review Clinton Administration's Energy Tax Proposals, Before the Senate Finance Committee, 103rd Congress, 1st Session (Response of Lloyd Bentsen, Secretary of Treasury Department) (April 20, 1993).

the tax, then imposing it on the end-user rather than the city-gate best accomplishes this goal.

An excise tax would be collected primarily by utilities and added to the bill of each customer. Because most gas utilities have computerized billing systems and are already structured to collect state sales taxes, the tax could be implemented quickly and efficiently without an extra burden on the Treasury Department. Other sellers to end-users (i.e. marketers) also have sophisticated billing systems capable of collecting a Btu tax. This excise tax on gas would mirror what is currently done with the telephone excise tax.

In addition, there are approximately 5300 investor-owned, member-owned and government-owned gas and electric utilities, and of them, only 350 or so of any significant size. By structuring the tax such that utilities and other last sellers of gas are responsible for collecting the tax (though not ultimately paying for the tax), the number of tax remitters would be dramatically reduced and the potential for tax avoidance would be minimized.

Choosing principally the city-gate as the collection point as the Administration proposes accounts for only 60 percent of the gas consumed in the U.S. The remaining 40 percent consists of thousands of relatively small transactions involving primarily custody but not title changes in gas. Thus, gas utilities do not take title to or administratively control 40 percent of the gas that goes through their system. As a result of industry restructuring, there is no longer a clearly definable "city-gate" in the natural gas industry. More importantly, given the number of pipeline to pipeline transfers involved in transporting gas, including small diameter, short distance pipe that delivers gas to many end-users, there is the potential for some to avoid paying the tax collected at the city-gate. Further, under FERC Order 636², pipelines own little or none of the gas they transport to the LDC system. Thus, the city-gate collection point becomes difficult because neither entity has title to the gas. Indeed, for much of the gas delivered to the utility, for which the utility is just a transporter, the pipeline and utility do not even have contractual privity. There is no basis for the pipeline to bill the utility for these quantities.

Imposing the tax at any point along the pipeline, entrance or exit, complicates tax collection. Taxing natural gas at the point-of-entry would require a massive tracking system that would be difficult to manage and measure for accuracy while creating much complexity and confusion. A natural gas purchase will typically consist of many individual transactions, such as between the producer and shipper (person arranging deal if the ultimate consumer does not do so), shipper and ultimate consumer, shipper and pipeline, shipper and storage owner, shipper and other shippers, pipeline and an upstream or downstream pipeline and shipper and other customers. Because of restructuring under Order 636, interstate pipelines will no longer buy or sell virtually any of the gas that goes through their pipelines or have knowledge of the actual end-user or end-use.

B. Minimizing Administrative Burdens

Imposing the tax at the end-user level reduces the cost of the tax to consumers by avoiding many of the administrative problems associated with collecting it at the city-gate. First, production, gross receipts and state and local utility taxes are often imposed as a percentage of authorized utility revenues or rates. If the tax is imposed upon the end-user as an excise tax, the compounding of state or local taxes on top of the Btu tax would not occur. Collecting the tax at the city-gate or other points upstream builds the tax increase into the cost of energy where the local jurisdiction imposes a sales or gross receipts tax on utility bills. In some states, these taxes could increase the burden of the tax by up to 15 percent above the payment if the tax was collected at the retail level.

Many states have these piggyback taxes, but not all. In the State of New York, for example, the gross receipts tax is 5.61 percent and 2.35 percent tax for the City of New York. Additionally, up to 8.25 percent is added to this as a sales tax, resulting in a total exceeding 16 percent. Illinois imposes gross receipts taxes of five percent and the City of Chicago adds a municipal gross receipts tax of eight percent, while the State of Texas imposes a two percent gross receipts tax on residential users of gas and the City of Houston imposes a four percent tax.

²The Federal Energy Regulatory Commission issued Order Nos. 636, 636A and 636B that provide for a major restructuring of the way interstate natural gas pipelines work. The impetus behind the major restructuring rule is to allow pipelines for the first time to sell gas at negotiated rates similar to the way non-regulated companies sell gas and ensure that gas buyers have greater access to the competitive wellhead market. The central feature of the restructuring rule is the unbundling of interstate pipeline sales and transportation services. However, pipelines are permitted to offer sales and transportation services in a repackaged format if the rate for each service is separately stated.

Second, administering the proposed feedstock exemption and other non-fuel use exemptions would be difficult to administer at any point above the end-user level. The Administration's proposal would allow for a natural gas feedstock exemption (natural gas used by the buyer for non-fuel purposes) from the Btu tax. For much gas delivered to the utility for which the utility is a transporter, identifying the end-use function may be difficult. Because of restructuring in the natural gas industry, pipeline operators rarely know the end-use of the gas they are transporting. The seller to the ultimate buyer is in the best position to know whether the natural gas would have a non-fuel use and thus qualify for this feedstock.

Third, imposing the tax at the end-user level would eliminate the timing problem associated with gas storage and gas imbalances. The Administration's proposal will require owners of natural gas storage facilities to pay taxes on their inventories or "floor stocks." For pipelines, and some utilities, the Btu tax imposed on storage gas would reach some gas which may never be consumed since it is injected into storage in order to maintain the operational integrity of the storage facility. Taxing gas in storage creates a timing problem, where the tax may be paid far in advance of ultimate sale and subsequent collection. Almost one trillion cubic feet of gas goes into storage facilities and may not be consumed for as long as a year.

C. Flow Through and Regulatory Lag

Third, the end-user collection point best achieves the Administration's goal of flowing through the tax and minimizes the gas company's exposure to a regulatory lag problem.³ Pass through can be approached in either of two ways: (1) applying the tax directly on the ultimate consumer in the form of a natural gas excise tax; or, (2) including the tax in the original cost of the gas commodity. If the tax is an excise tax collected from the end-user, the seller of gas most likely could avoid incurring the costs of pipeline or utility rate and tariff proceedings. This is because the legal incidence of the tax is at the retail level and the tax is not a part of the utility's cost of service, subjecting the utility to a rate hearing.

If history is any guide, regulators will treat the flow through of taxes differently in each jurisdiction. City-gate collection creates difficulties due to the different points and allocation of transportation gas flowing through it. For some companies, there would be no mechanism to allow a flow through at the city-gate. In many cases, a rate case would have to be filed. Some jurisdictions might not allow full pass through of the costs of the tax and subject utilities to absorbing those costs. Several states commissioners have indicated they are not willing to allow utilities to pass through the tax in consumer rates and the State of California has held hearings on the issue. In other jurisdictions, regulatory lag might become a problem, and a persistent one, given that the tax rate will change each year.

D. Promoting Other Government Policies

An excise tax best meets the Administration's stated Btu energy objectives, including promoting energy conservation and a clean environment. Imposition of the tax at the city-gate impairs the ability of the industry to meet help the nation reach these objectives. Collection of the tax is critical to those with long-term fixed price contracts, which serve government policies and consumers by providing long-term gas supplies at stable prices.

Imposing the tax at the retail level avoids the need to pre-empt state or federal ratemaking treatment of costs related to providing utility service. This approach would eliminate the necessity of statutory language aimed at encouraging regulators to flow through the tax in customer rates.

V. PREEMPTION

If a Btu tax is imposed on our industry and at the city-gate, A.G.A. urges Congress to enact legislation that will direct state PUCs to allow utilities to effectively and expeditiously flow through the tax costs to customers in their gas bills. The Administration is considering a normalization type approach for effectuating recovery of energy tax costs. However, the Administration's approach increases the potential damage to gas companies by denying certain tax benefits (i.e., accelerated depreciation of public utility property and investment tax credit reflected in rates over the life of the asset) for periods which the tax is not completely passed through to consumers. An excise tax on the end-user is the best mechanism to ensure the immediate and complete flow through of the tax.

³ Regulatory lag refers to the time between the imposition of the tax and reflection of the tax in customer's billed rates. In most jurisdictions, gas companies would go through a rate or tariff proceeding to include the costs of the tax in customer rates, which could take up to a year or more. During this waiting period, the utility would carry the cost of the tax.

A.G.A. believes the normalization approach is not an effective tool to encourage regulators to flow through the tax. Our preliminary figures indicate that the magnitude of the excise tax would greatly exceed the size of the tax benefits of normalization for gas utilities. We are concerned that regulators may opt for the politically popular short-term action of denying flow through and sacrificing the smaller normalization benefits to avoid the larger gas tax. Utilities could be doubly penalized where they are denied flow through and lose their tax benefits of normalization.

The normalization approach has not been previously applied for compelling the flow through of an energy tax. There is a danger, based on past experience, of disputes arising between utilities, regulators and the Internal Revenue Service (IRS). Given the problems which have already occurred involving the application of the normalization rules, it would be inappropriate to overload this already controversial mechanism with a new mandate—to assure the recovery of an expense. For example, in *City of LA v. CPUC*, 15 C. 3d 680, utilities were penalized nearly \$500 million when the IRS interpreted normalization to require the utilities to reflect tax benefits in a different manner than the state PUC. Similarly, recent disputes between utilities and regulatory commissions regarding normalization and the treatment of consolidated tax return losses expose utilities to enormous penalty risks.

A.G.A. therefore urges Congress, if a Btu tax at the city-gate is unavoidable, to add provisions in the tax legislation other than normalization that would effectively and immediately enable utilities to completely pass through the costs of the tax to consumers. We will work with you on developing appropriate language for this purpose.

VI. DOUBLE TAXATION

If the tax is not collected from the end-user, A.G.A. urges Congress to address the issue of double taxation caused by gross receipts and other state and local taxes by including legislative language that would exclude the Btu tax from any form of federal, state, local or other taxation. Utilities should only be required to pay the pipeline what they collect from their customers.

VII. METHANOL AND ETHANOL EXEMPTION

The Administration has proposed an exemption for methanol and ethanol in vehicular applications. If this exemption is to remain, A.G.A. feels strongly that vehicular compressed natural gas should be treated the same as methanol and ethanol. The proposed exemption for methanol and ethanol would substantially distort the market for alternative fuel vehicles and potentially hamper the emerging market for compressed natural gas vehicles. All alternative transportation fuels should be treated the same or distortions will occur in that market.

VIII. CONCLUSION

A.G.A. opposes all broad-based energy taxes because of their impact on the economy, balance of trade, lower income households, competitiveness and the natural gas industry. Before any new taxes are adopted, we encourage Congress to work with the Administration in finding additional spending cuts. A.G.A. urges Congress to consider a national consumption tax as a long-term deficit strategy. If a VAT is imposed along with a Btu tax, we urge Congress to phase out the Btu tax once the VAT is in place.

If some form of energy tax is adopted, A.G.A. believes an increase in the federal gasoline excise tax and/or oil import fee would foster environmental, efficiency and domestic security goals. If Congress chooses a Btu tax, A.G.A. opposes collection of the tax at the city-gate. A.G.A. is united with the natural gas industry in urging that any Btu tax enacted be paid by the ultimate consumer and collected by the entity making the sale to that purchaser. Attempting to impose the tax at any point other than the end-user will result in significant burdens in collection, administration and flow through of the costs of the tax in consumer rates. It would also thwart the Administration's stated goal of preventing serious economic distortions.

If a Btu tax is to be collected at the city-gate, strong preemption language is needed to minimize the costs of absorption upon utilities. To avoid the problem of double taxation, Congress should adopt legislative language that excludes the Btu tax from the tax base of any form of federal, state, local or other taxation. Local utilities should only be required to pay what is collected from end-users. Finally, all alternative fuels should be treated equally.

| Short-term Retail Price Impacts of Clinton Energy Tax Proposal After Phase-in (\$/MMBtu and Percent Change) | | | | | |
|--|--------------|-------------|----------------|--------------|--------------|
| | Natural Gas | Electricity | Distillate Oil | Residual Oil | Coal |
| Residential Sector | 0.27 (4.7%) | 1.00 (4.1%) | 0.64 (8.6%) | N/A | N/A |
| Commercial | 0.27 (5.7%) | 1.00 (4.4%) | 0.64 (12.0%) | N/A | N/A |
| Industrial | 0.27 (11.0%) | 1.00 (6.9%) | 0.64 (13.0%) | 0.60 (23.1%) | 0.26 (15.3%) |
| Electric Utility | 0.27 (12.6%) | N/A | N/A | 0.60 (25.1%) | 0.26 (18.4%) |

Note: Tax rate is 25.7 cents per MMBtu on all energy except oil. Tax rate on oil is 59.9 cent per MMBtu. Retail price impacts reflect energy used in transportation and processing after point of collection of the tax. Assumes no reallocation of utility cost by class of service. Over the longer-term such reallocation would likely take place.

Uses national average prices of energy as published by DOE in the monthly Energy Review which do not include sales taxes. Projected tax effects do not include compounding of gross receipt taxes. Effects of sales taxes and gross receipt taxes would raise all energy prices. Excludes effects of inflation or projected increases in energy prices.

STATEMENT OF THE AMERICAN METHANOL INSTITUTE

It is my pleasure to present this Statement on behalf of the American Methanol Institute, whose members produce virtually all of the methanol used as a fuel and as a chemical feedstock in the United States. In the United States, methanol is produced almost entirely from abundant supplies of domestic natural gas. In recent years, the quest for energy diversity has caused an increase in demand for methanol and other alcohol fuels products. Over one-fourth of the methanol currently marketed in the United States is used to manufacture MTBE (methyl tertiary butyl ether), the most widely-used clean-fuel gasoline additive today. Last year approximately 2 billion gallons of MTBE were blended into gasoline.¹ In addition, all of the major U.S. automakers now sell "flexible fueled" automobiles which operate on methanol, and dedicated methanol-fueled buses are in commercial use. Indeed, methanol is a remarkably safe, high-performance and efficient fuel, having been used as the sole fuel for the Indianapolis 500 for the last 28 years.

In recent years, the domestic methanol industry has begun to expand rapidly to meet the growing demand for clean fuels and fuel additives. Methanol is produced commercially almost exclusively from domestic natural gas. Eighty percent of the methanol consumed in the United States is produced domestically, and about 80 percent of the imported methanol is produced in Canada. Less than .5 percent of the United States methanol is imported from the Middle East, even though the price of natural gas there is much lower than its price in the United States.²

Even if the price of foreign natural gas remains significantly lower than the price of U.S. gas, methanol for the U.S. market will continue to be supplied from domestic natural gas. Overseas, and particularly in countries with very large gas resources, cheaper feedstock prices are more than offset by the high costs of construction, working capital and political risk. Add the greater costs for shipping, storing and handling foreign methanol for the U.S. market, and it becomes clear why the methanol industry is investing in America to produce for the American market.

As energy security and environmental policies fostered new fuel uses for methanol, the industry has pursued a conservative, competitive, market-oriented business strategy. Methanol is the only alternative fuel that has sought no environmental waivers or weakened standards to gain a competitive edge over other fuels, and has sought no tax or other subsidies, including the risk aversion and cross subsidy that results when capital costs are put into a consumer ratebase.

It was energy security—the desire to lessen our transportation sector's almost complete dependence on petroleum-based gasoline and diesel—that prompted the search for alternative fuels. All fuels made from natural gas, including methanol and compressed natural gas ("CNG"), make it possible for the U.S. economy to use more domestic natural gas to reduce our dependence on the Persian Gulf Crude Oil. In addition to proven energy security benefits, environmental policy now plays a strong complimentary role in the demand for greater use of natural gas-derived fuels. As a fuel, and as a gasoline additive, methanol brings clear environmental benefits over the benzene and other toxic chemicals in gasoline that are replaced by methanol and MTBE.

The methanol industry has one tax policy priority: even-handed treatment of all competitive fuels.

I. PROPOSED BTU TAX

As modified by the Administration on April 1, 1993, and explained in a release issued in April 1993, the Administration's proposed energy or BTU tax would not be imposed upon ethanol, methanol, ETBE (ethyl tertiary butyl ether), MTBE, and feedstocks used in their production. AMI supports this BTU tax proposal modification because it treats all alcohol fuels in the same manner. This even-handed treatment of methanol and ethanol reflects sound tax policy because it does not use the tax law to favor one product over another.

Ethanol supporters sometimes argue that ethanol deserves special tax treatment because it is made from corn and sugar cane produced by American farmers. However, encouraging even more extraordinary production of crops by creating new artificial demand for those crops used to make a product that cannot compete in the marketplace without subsidies is not helping consumers or taxpayers. In 1992 1 billion gallons of ethanol were blended into gasoline, at a minimum tax credit under

¹ CRS Issue Brief: *Alternative Transportation Fuels: Are They Reducing Oil Imports?* Updated April 9, 1993, Congressional Research Service, The Library of Congress at page CRS-6. (Referred to hereinafter as "CRS Study").

² Petrochemical Consultants International, from U.S. Department of Commerce and International Trade Commission statistics.

section 40 or equivalent fuel excise tax benefit of 54¢ per gallon.³ The market, not the tax law, should dictate demand and investment, a concept adopted by this Committee as the fundamental principle underlying the Tax Reform Act of 1986. Accordingly, we concur with the Administration's fuel-neutral decision to treat both ethanol and methanol the same under the BTU tax and request that the Committee adopt this tax neutral posture. In addition, we ask the Committee to apply this principle of tax parity in its consideration of the motor fuels excise tax, discussed below, and any further legislative tax preferences for ethanol, such as repeal of section 87, which provides for the inclusion of the ethanol tax credit in taxable income.

We note that as proposed by the Administration, the BTU tax would be imposed on all natural gas, and the exemption for methanol and MTBE would be provided through a downstream refund or credit mechanism to the methanol manufacturer. In a situation where the natural gas is used for the production of methanol, such a credit refund mechanism appears cumbersome at best. We suggest that the imposition of the BTU tax on natural gas should not apply when the natural gas is used as a feedstock for an exempt product. This would simplify the administration of the tax.

II. PROPOSED EXTENSION OF THE MOTOR FUELS EXCISE TAX

The current federal motor fuels excise tax is imposed on gasoline and special motor fuels, diesel fuel used for highway transportation, special motor fuels used in motor boats, and diesel fuels used in trains. (CNG is not subject to the motor fuels excise tax only because it is not a liquid). As set forth in the Appendix, the rates of tax are reduced for fuels containing ethanol or methanol not produced from petroleum, natural gas or coal. Although these exemptions appear applicable to both methanol and ethanol fuels, in practice they are only available to ethanol fuels because there is no commercial production of methanol from other than natural gas, petroleum and coal. Thus, the current motor fuels excise tax provides a substantial tax subsidy for ethanol fuels (and also CNG) which discriminates against methanol.

The current motor fuels excise tax is but one of several provisions of current law that provides an unfair tax subsidy for ethanol which discriminates against methanol. Under Internal Revenue Code section 40, an alcohol fuels credit of between 54¢ and 64¢ per gallon is provided for ethanol. Moreover, under Treasury Regulation §1.40-1 a credit is available for ETBE, an ether created through a chemical reaction of ethanol and isobutylene (a petroleum byproduct), even though the section 40 credit is expressly limited by statute to "alcohol," not to chemicals produced from alcohol.⁴ These credits are not available to methanol and MTBE produced from natural gas.

The section 40 credit and the substantial reduction in fuel excise taxes available for ethanol and ETBE result in enormous tax subsidies, without which ethanol would not be competitive as a fuel. We urge the Committee in its consideration of the motor fuels excise tax to investigate the competitive disparities already provided by the existing ethanol subsidies and provide even-handed treatment for all alcohol fuels.

CONCLUSION

In summary, the American Methanol Institute supports the Administration's BTU tax proposal modification because it does not favor one alcohol fuel over another. Rather, all alcohol fuels are treated in the same manner. We urge the Committee to adopt this principle of tax parity among alcohol fuels in its consideration of the proposed BTU tax as well as in its consideration of the extension of the motor fuels excise tax, and other existing and proposed tax preferences for ethanol.

³ See CRS Study at CRS-6.

⁴ The Bush Administration Treasury Department has estimated that this regulation allowing the alcohol credit to ETBE will cost the Treasury \$2 billion. See Statement of Assistant Secretary Gideon before House Committee on Ways and Means at 6-9 (February 1, 1990).

APPENDIX

| | Exemption | Rate |
|---|------------|--------------------------------|
| Excise tax on motor fuels: | | |
| 1. Gasoline and special motor fuels §4041(a)(2) and 4081 | | 14.1¢/gal. |
| 2. Diesel Fuel §4091 and 4041(a) | | 20.1¢/gal |
| 3. Fuels for noncommercial aviation: | | |
| gasoline—§4041(c) and 4081 | | 15.1¢/gal. |
| jet fuel—§4041(c) and 4091 | | 17.6¢/gal. |
| 4. Fuels used by commercial cargo vessels on inland waterways §4042 ¹ | | 15¢/gal.—1992 20¢/gal.—1995 |
| Exemptions from §4041 motor fuels excise tax for certain alcohol fuels: | | |
| 1. For fuels containing ethanol not produced from petroleum, natural gas, or coal (§4041(k) and 4081(c)): | | |
| a. gasohol—5.7% alcohol | 3.08¢/gal. | 11.02¢/gal. |
| b. gasohol—7.7% alcohol | 4.16¢/gal. | 9.94¢/gal. |
| c. gasohol—at least 10% alcohol | 5.4¢/gal. | 8.7¢/gal. |
| d. dieselhol—at least 10% alcohol | 5.4¢/gal. | 14.7¢/gal. |
| e. aviation fuel—at least 10% alcohol | 5.4¢/gal. | 9.7/12.2¢/gal. |
| 2. For fuels containing methanol not produced from petroleum, natural gas or coal (§4081(c)(4)(A)) : | | |
| a. gasohol—5.7% alcohol | 3.42¢/gal. | 10.68¢/gal. |
| b. gasohol—7.7% alcohol | 4.62¢/gal. | 9.48¢/gal. |
| c. gasohol—at least 10% alcohol | 6.0¢/gal. | 8.1¢/gal. |

¹ None of the excise tax exemptions are applicable to this category of fuel excise tax.
American Methanol Institute May 6, 1993

STATEMENT OF THE ATLANTIC RICHFIELD COMPANY

This statement regarding President Clinton's proposed BTU energy tax is submitted on behalf of Atlantic Richfield Company (ARCO). ARCO is a worldwide, integrated hydrocarbon corporation with operations encompassing all aspects of the oil and gas industry, including exploration, production, transportation, processing, refining and marketing. ARCO also mines and markets coal and has significant interests in two petrochemical companies.

The BTU Energy Tax Proposal

ARCO has indicated its support for the concept of a BTU tax which would achieve, in conjunction with other revenue measures and real spending reductions, meaningful deficit reduction. Over the weeks since the BTU tax was first proposed, significant progress has been made by the Administration in addressing many design issues. However, several key elements remain. We submit the following design criteria still need to be incorporated into the proposed BTU energy tax to avoid distortions in the marketplace and unfair competition from foreign produced energy.

I. Collection Point

The point in the energy cycle at which the BTU energy tax is imposed is extremely important for several reasons. Imposition at improper points in the cycle can materially distort demand for domestic versus imported energy products. The burden of any tax should fall equally upon all energy products consumed, regardless of whether domestically produced or imported. If our Nation's dependence upon foreign oil is to be minimized, the American energy industry must not be burdened to a greater extent than its international competitors. In this regard, there is general agreement within the U.S. energy industry that competitiveness is fostered by imposing any energy tax as close to the ultimate consumer level as possible. Taxation at the consumer level also minimizes additional issues regarding royalty and severance taxes for domestic energy producers, which can produce distortions as to regional burdens regarding the tax.

Measurement, documentation and other enforcement considerations should also influence the choice of collection point. Revenue leakage should be minimized by imposing the tax at a point where exempt uses of taxable energy can be discerned by the collection agent. Utilization of existing collection points regarding motor fuel taxation might also simplify implementation and enforcement.

Finally, taxation at the consumer level would have the most impact regarding achievement of the Administration's energy conservation and environmental goals. In contrast to the stated objectives of this legislation, producer level collection points also will result in unintended loss of domestic energy production, jobs, and increased dependence upon foreign energy imports.

We turn to the specific points of imposition for the tax as stated in the Administration's proposal:

A. Petroleum Products

ARCO supports the Administration's decision to impose the BTU energy tax at the outlet rather than the inlet to the refinery. Imposing the tax at the inlet would create unfair competition from imported petroleum products by taxing domestic refiners, but

not foreign refiners, on energy lost in the refining process. Imposing tax at the outlet avoids this problem. Taxing at the refinery outlet will also avoid BTU disparity in crude oils by taxing the more uniform BTU content of product lines.

Recent pronouncements issued by the U.S. Department of the Treasury have stated that the BTU energy tax on petroleum products would be imposed upon the refiner at the "tailgate" to the refinery. Because this term does not have uniform definition within the industry, it should be defined for purposes of this tax in a manner which avoids complexity and simplifies implementation. Refineries have different configurations, with multiple stages of processing, return streams for waste gas, inconsistent measuring points, and storage either on or off the premises. Products may be transported either by pipeline, rail car, truck, or ship. There is no "gate" per se as the term would suggest, but a complex arrangement of pipelines which may or may not be metered.

B. Natural Gas

The Administration would impose the BTU energy tax upon the local distribution company or industrial end user upon delivery from the pipeline, with collection of the tax by the pipeline. In contrast to this proposal, ARCO suggests that the tax on natural gas be imposed upon the end user only and collected by the last seller to such end user. Such an alternative would:

- o avoid having to define the term "pipeline",
- o minimize pipeline tariff and PUC ratemaking issues,
- o accommodate winter storage and other measures taken to ensure supply reliability,
- o simplify the exemption for petrochemical and other non-fuel uses of gas,
- o avoid issues regarding fixed price contracts,
- o avoid severance and royalty issues for producers transporting gas, and
- o avoid complexities regarding the treatment of product swaps.

By law certain liquified petroleum gases (propane and normal butane) must be odorized for safety purposes to aid leak detection whenever they are sold for fuel purposes. An exception to these rules is for sales to refiners that process or blend such products into petroleum products. ARCO thus suggests that the tax on liquified petroleum gases be imposed at the point where such products are odorized for commercial use as fuels, or in the case of a refinery, when such products are processed or blended into taxable petroleum products.

C. Coal

ARCO supports: (i) imposing the tax on coal on the utility or other industrial end user of the coal; and (ii) collecting the tax at the time the coal is unloaded at the utility or industrial user's coal storage facility. Imposing and collecting the tax in this manner for coal will eliminate any potential severance tax, black lung excise tax, and royalty issues related to the BTU tax and would also give rise to greater accuracy, fairness, and audit in the administration of the BTU tax.

D. Other Taxable Energy Products

ARCO supports the other collection points as proposed in the Administration's BTU energy tax proposal.

II. Exemptions

The Administration has listed a significant number of exemptions relating to non-taxable uses of energy. While ARCO supports the exemptions that have been announced, the following clarifications should be incorporated into legislation to enhance implementation and minimize marketplace distortions. Whenever possible, we would also recommend the use of a certification procedure to exempt products from the tax. Procedural safeguards could be incorporated into any exemption certificate process to safeguard revenue enforcement issues.

A. Nonfuel uses of fossil fuels

The Administration's proposal states that the tax would not be imposed on either nonfuel uses (eg. feedstock uses) of fossil fuels or nonfuel products (such as asphalt, lubricants, and waxes). ARCO also suggests specific reference to the following additional nonfuel uses and products in either the statutory language or legislative history:

- o Crude oil unless burned as a fuel without further refining
- o Calcined coke
- o Green coke used as a feedstock for calcined coke
- o Petrochemical feedstocks
- o Coking coal used to make coke for steel production
- o Crude oil, natural gas, and liquified petroleum gases injected or re-injected into a reservoir
- o Liquified petroleum gases and natural gasoline added to lighten a crude oil stream for transportation or other purposes
- o Natural gas used to maintain operating pressure in gas storage facilities and pipelines (cushion gas and line-pack)
- o Liquified petroleum gases used in fertilizers and aerosol products
- o Unfinished or intermediate refined products that are subject to further refining

B. Exported fuels and bunker and jet fuel used in international transportation

If the buyer certifies that the product or fuel is to be exported from and consumed outside the U.S., or other proof of export and consumption is provided, the product should not be subject to the BTU energy tax even if title passes in the U.S. This would be consistent with the rules regarding Foreign Sales Corporations.

For jet fuel, the term "international transportation" should be defined as a flight where the point of origin or ultimate destination is a point outside the U.S. This is necessary for domestic refiners to compete with foreign bonded jet fuel that will be exempt from tax under 19 USC §1309.

For bunker fuel, the term "international transportation" should include "noncontiguous domestic voyages" as defined under 46 CFR 390.5 (c)(5) for purposes of the Merchant Marine Act of 1936, as amended (46 USC §1177). The majority of bunker fuel used on such voyages is generally consumed in international waters. Because it is very difficult for a refiner to establish that bunker fuel will be consumed in international waters, and because a substantial amount of such fuel will be exempt, a strong argument also could be made for extending this exemption to all bunker fuel.

C. Coal seam methane

This exemption should include all coal seam methane gas as defined under §29 of the Internal Revenue Code ("IRC"). A

distinction for one source of coal seam methane gas does not appear to be justifiable.

D. Natural gas used in enhanced recovery for heavy oil

ARCO suggests this exemption not be limited to heavy oil. Enhanced oil recovery ("EOR") incentives already exist under U.S. tax policy due to the hardships associated with such projects. Expansion of this exception from the BTU energy tax to all EOR projects would be consistent with such tax policy.

If the exemption is to be limited to heavy oil, ARCO suggests use of a definition similar to the that used for heavy oil under §4991(e)(3) of the windfall profit tax (ie. oil with an API gravity of 16 degrees or less). The definition for EOR could be that contained in IRC §43. Natural gas used in EOR should include, among other things, natural gas and liquefied petroleum gases purchased to produce steam and to power equipment required to comply with environmental standards. The exemption should also be extended to fuel oil and synthetic gas used for such purposes.

III. Use Tax

Under the Administration's proposal, a use tax would be imposed on fuel uses of fossil fuels and their taxable products on which the energy tax has not been imposed. This use tax would apply to the fuel use of products that have not reached the point at which the energy tax is normally imposed, to the nonexempt use of products purchased under claim of exemption, and to the nonresidential fuel use of home heating oil.

While the Administration has proposed certain limited exemptions from this use tax, it is ARCO's opinion that a more general exemption is needed for fuel consumed in the creation of a taxable energy product prior to the statutory point of imposition for the energy tax. Without such an exemption, the energy industry would be the only American industry that has both its energy use and its product subject to tax. This is unfair and places an additional burden upon an industry that is already laden with significant regulations and environmental requirements.

Specifically for crude and petroleum refined products, fuel used to extract, gather, process, transport and refine such products should be exempt from the use tax if consumed prior to the refinery tailgate. For coal, the exemption would apply to all fuel use up to the point of delivery to the utility or industrial end user. For natural gas and gas liquids other than from a refinery, fuel use would be exempt up to the point of sale to the ultimate user by the last seller.

For purposes of this exemption, incidental fuel use such as heating/cooling of facilities and equipment, fuel used for reinjection compressors, generation of electricity for lighting and powering facilities and equipment, fuel used for gathering systems including gathering system compressors, and for initial processing of fossil fuels (e.g., separation of crude oil from gas, drying of coal, extraction of liquids from gas, etc.) would also be exempt.

If the aforementioned general exemption for fuel used to make fuel is not possible, then the use tax should not apply to fossil fuels used on the premises where extracted for the purpose to extract, produce or process fossil fuels. For purposes of this exemption, the term "on the premises where extracted" should include: (1) a lease; (2) a field; (3) a unit; (4) a reservoir or mine containing reserves of fossil fuels in which that

taxpayer has an economic interest, and (5) a production or processing facility servicing one or more of the above leases, fields, units, reservoirs or mines.

For purposes of this exemption, the phrase "to extract, produce, or process fossil fuels" should also include all of the aforementioned incidental fuel uses of such fossil fuels used on-site or in connection with on-site production and processing activities.

In addition, the use tax should not apply (1) to crude oil, crude oil derived fuels (eg. petroleum coke and residual fuel oil) and waste/by-product fuels from the process stream which are used as fuel in a petrochemical plant, refinery, diesel fuel topping plant, or cogeneration facility if it is supplying power to that refinery or plant; or (2) to natural gas and natural gas derived fuels used in a natural gas processing, liquefaction or fractionation plant as fuel.

Under the Administration's proposals, oil, natural gas or natural gas liquids taken from a pipeline throughput and used as fuel in running compressors on the pipeline would be subject to the use tax (in contrast to non-fuel pipeline volume shrinkage plus natural gas used as cushion gas or line pack which should be considered a non-fuel use of such gas not subject to tax). In view of this desire, there may be issues regarding the definition of a "pipeline".

First, there are pipelines that move products subject to the energy tax, e.g., product pipelines and gas pipelines moving taxable fuel to consumers. Additionally, there are numerous pipelines that are used: (i) as area or field gathering systems; (ii) as lines moving crude oil or natural gas from offshore platforms to shore bases; (iii) as lines moving non-taxable feedstocks, such as oil to refineries and petrochemical feedstocks from a refinery to a petrochemical plant; (iv) as gathering systems for fossil fuels from remote frontier areas to collection points for shipment to refiners; and (v) as lines to connect processing facilities within a refinery, petrochemical plant, gas plant or fractionation facility, etc.

Assessing a use tax on all pipeline fuel use (in its broadest sense) would create in many instances a tax where there is no consumer of a taxable product. Further, many pipeline tariff agreements prohibit pass-through of such taxes. In other instances, the increased cost of pipelines due to the use tax could reduce the wellhead value used to calculate governmental royalties and severance taxes. Accordingly, ARCO would suggest amendment of the Administration's proposal to exempt pipeline fuel use from the energy tax.

IV. Oxygenates

The Administration's proposal would exempt certain oxygenates from the BTU energy tax. Unlike ethanol, which is generally blended with gasoline after the terminal rack, MTBE, ETBE, and other oxygenates will be added by the refiner to the gasoline before the point of imposition of the BTU tax. As such, a system of collection will have to be developed to ensure that the oxygenates exemption is implemented and that the oxygenate component of the finished gasoline is not taxed. Inasmuch as the refiner will have records as to the volumes of oxygenates and gasoline that have been blended, ARCO suggests that the refiner compute the energy tax due by multiplying the volume of each product blended by the appropriate rate of taxation. (A similar approach could be used for natural gas liquid blendstocks that would only be taxed at the base rate of taxation).

Example: During 1996, a refiner blends 110 gallons of MTBE and 130 gallons of ETBE with 1760 gallons of gasoline to make 2000 gallons of oxygenated gasoline. (It has been assumed for purposes of this example that one gallon of oxygenated gasoline contains 11 percent MTBE or thirteen percent ETBE by volume and that the average energy content of taxable gasoline is 120,000 BTU/gallon. The percentage of oxygenates mixed with gasoline can vary for each sale).

In computing the BTU energy tax due at the refinery tailgate, the refiner would compute that tax as follows: 1760 gallons of gasoline X 120,000 BTU/gallon X \$0.599/MMBTU plus 240 gallons of oxygenates not subject to tax. The net tax amount due of \$126.51 would be transmitted to the government via a periodic BTU tax form.

If the terminal rack or its equivalent is ultimately determined to be the point for imposition of the tax for gasoline (in lieu of the refinery tailgate), a system of credits to the blender will have to be developed to compensate for the fact that the volume and type of oxygenates present in the gasoline may not be apparent at that point in the distribution chain. The blender could be permitted to claim such credits as the oxygenates were withdrawn from inventory.

V. Natural Gas Liquid Blendstocks

When natural gas liquids are blended with gasoline, issues arise similar to those encountered with oxygenates. In order to effectuate the Administration's desire to tax natural gas liquids and natural gasoline only at the base rate of taxation for the BTU energy tax, a system of collection will have to be developed to ensure that such liquids are not taxed at the supplemental rate when blended with gasoline by a refiner.

VI. Other Definitions

To ease implementation of the BTU energy tax, ARCO recommends use of the following definitions which are generally accepted in the energy sector:

- o Natural Gasoline - Heavy hydrocarbon molecules, e.g., pentane, hexane and heptane separated (whether naturally, mechanically or through processing at a refinery or gas processing or fractionation plant) from natural gas or crude oil:
- o Natural Gas - Hydrocarbons which exist in a gaseous phase at atmospheric temperature and pressure after passing through surface separating facilities.
- o Coal - As defined in ASTM (American Society for Testing and Materials) D 121, the term "coal" includes all ranks of coal as defined in ASTM standard D 388, including anthracite, bituminous, sub-bituminous, and lignite.
- o Crude Oil - A mixture of hydrocarbons which remains liquid at atmospheric temperature and pressure after passing through surface separating facilities. (Treasury Regulation §1.613A)

- o Liquefied Petroleum Gases - Butane, isobutane and propane separated (whether naturally, mechanically or through processing at a refinery or gas processing, liquifaction or fractionation plant) from natural gas, crude oil or natural gasoline.
- o Refined Petroleum Products - Items produced in a refinery, but not including items produced in a gas processing plant, a fractionating plant or petrochemical plant.
- o Refinery - Refinery should be defined expansively to include integrated refining/cogeneration/petrochemical manufacturing facilities and processes. A refinery should also be defined with respect to its physical characteristics rather than legal ownership arrangements.
- o British thermal unit (BTU) - A BTU should be defined as the amount of energy required to increase the temperature of one pound of water one degree fahrenheit at standard temperature and pressure.
- o Actual BTU Content: Coal- Actual BTU Content for coal should be the "gross calorific value" as determined by ASTM standards D 2015 (Adiabatic method); D 3286 (Isoperibol method); D 1989 (Microprocess method).
- o Independent Power Producers - This definition should include any "Qualifying Facility" as defined in the Public Utility Regulatory Policies Act (PURPA).
- o Fixed Price Contract - This term should be defined to include any binding contract entered into before the date of enactment if the seller is not permitted to charge the buyer for the BTU tax.

STATEMENT OF THE BIG RIVER ZINC CORPORATION

Mr. Chairman, and Ladies and Gentlemen of the Committee:

I am Edward J. Schmidt, President of Big River Zinc Corporation. I am also Chairman of the American Zinc Association, which represents all the major zinc producers in North America. I comment herein on the impact of the proposed Btu tax on Big River Zinc Corporation. Before describing the impacts, I will provide a little background on the relevant issues.

BACKGROUND

Big River Zinc Corporation

Big River Zinc Corporation (BRZ) is located in Sauget, Illinois. BRZ produces about 89,000 tons per year of zinc metal and is the third largest primary zinc producer in the U.S. BRZ directly employs about 400 people and provides significant secondary employment in and around the St. Louis/East St. Louis area.

BRZ was formed in 1988 when Big River Minerals Corporation acquired BRZ's zinc refinery from Amax Zinc Corporation.

Zinc

Zinc is the third most used non-ferrous metal. Zinc is essential to sound animal and plant health, and there is no substitute. The Recommended Daily Allowance for zinc in adult humans is 15 mg. Zinc deficiency has been shown to result in retarded growth (dwarfism), delayed sexual maturity, anorexia, mental lethargy, rough or dry skin, hair loss, poor wound healing and increased susceptibility to infection.

Western world zinc metal consumption has grown from about 3.4 million tons per year in 1967 to an estimated 5.5 million tons per year in 1993, or about 2% per annum. The growth in zinc consumption has largely been driven by the need for steel products with longer life cycles, e.g., bridges, guardrails, transmission towers, automobiles, etc. This longer life cycle is accomplished by galvanizing the steel to provide an attractive, corrosion resistant finish. About 50% of all zinc consumed is now used in galvanizing.

Other major uses for zinc include diecasting (20%), brass (12%), and other uses (zinc oxide in tires, zinc metal in portable alkaline batteries, zinc nutrients in fertilizers, etc.).

Zinc will be a critical material to any U.S. infrastructure plan considering longer life cycles, recyclability, and environmental friendliness as goals!

U.S. Zinc Industry

The U.S. economy consumes about 1 million tons per year of zinc. Of this total consumption, only about 40% is supplied from U.S. producers because of the lack of operating capacity in the U.S.

Currently, there are three other primary zinc production facilities in the U.S. Zinc Corporation of America operates two facilities: one in Monaca, Pennsylvania, and one in Bartlesville, Oklahoma. Union Zinc operates a primary zinc refinery in Clarksville, Oklahoma. Of the four operating production units in the U.S., three use the electrolytic zinc process; the Monaca plant uses the electrothermic process.

The U.S. has not always been short of zinc production capacity. U.S. zinc production capacity has decreased steadily from 1 million tons per year in 1968 to 750,000 tons per year in 1975 to the current level of 450,000 tons per year (primary and secondary). During the period 1968 to present, ten U.S. zinc production facilities have been closed and one new facility was built (Union Zinc). The plant closures have all been economically driven, either due to the poor state of the world industry; more stringent environmental regulations in the U.S.; higher labor costs, power costs, taxes, etc., in the U.S.; and less attractive investment credits and/or subsidies in the U.S.

U.S. imports of refined zinc are itemized by country in Attachment I.

World-Wide Industry - Supply/Demand

Western world zinc metal consumption has grown 2% per annum from 1967 to the present. While U.S. zinc production has decreased markedly, new facilities and significant expansions have been built outside the U.S. to serve the growing market. Eighty-five percent (85%) of all zinc is produced by the electrolytic process.

A summary of zinc supply and demand for 1968 to present is shown in Attachment II.

Worldwide Zinc Industry - Price

Historically, zinc prices have tended to be cyclical. Zinc price history is shown in Attachment IIIa. These same prices are reflected in 1990 dollars in Attachment IIIb. Currently, world zinc prices (now London Metal Exchange - based) are at a 30 year adjusted low due to the world recession and large exports from the eastern bloc.

Given the current depressed state of the zinc industry and the inability of the western world (and even the zinc price) to influence exports from the eastern block, a number of zinc mine and smelter production facilities have been forced to close during the last six months. These closures include:

- (1) Cominco Ltd. announced its Trail, Vancouver, smelter would close for two months in 1993.
- (2) Pasminco announced permanent closing of an Australian mine.
- (3) Noranda in Canada announced a reduction in production of zinc concentrates by 40-50,000 mt.
- (4) Empresas Frisco in Mexico will close three of four mines employing a total of 1,165 workers.
- (5) Ruhr-Zinc is taking at least a two-month smelter cutback at its Datteln, Germany, smelter.
- (6) Kennecott Corp. announced the closure of its Greens Creek Mine in Alaska with 230 layoffs.
- (7) Compania Minera Tiwanaou in Bolivia is reducing concentrate production by 20%.
- (8) The Santa Rita and Yauri mines in Peru are rumored to be closing.
- (9) Canada's Curragh Resources has extended a shutdown of its SA Dena Has mine, reducing concentrate production.

Fortunately, no major U.S. producers have yet been forced to close, but all producers are operating under extreme economic hardship, and the four remaining primary zinc refineries only continue to operate because they were the fittest of a once much larger U.S. industry.

THE ELECTROLYTIC ZINC PROCESS

About 85% of all zinc is produced by the electrolytic process. Three of the four U.S. primary zinc plants employ the electrolytic process. This process has proven itself to be the most efficient, environmentally friendly process for zinc recovery.

In the electrolytic zinc process, the starting material is zinc concentrates purchased from zinc mines. These concentrates contain 50-60% zinc as zinc sulfide and are roasted at high temperature with air to convert the zinc sulfide to acid soluble zinc oxide. The zinc oxide is dissolved in a recirculating sulfuric acid solution to form a zinc sulfate solution. The zinc sulfate solution is purified and the zinc is then recovered as metal by electroplating the zinc onto an aluminum cathode, from which the zinc metal is periodically peeled off. The other result of the electrochemical deposition of zinc in this manner is that the zinc sulfate solution is converted to a sulfuric acid solution, which is then used to leach more zinc oxide.

In the electrolysis step, electricity causes the reduction and plating of the zinc. The reaction is an electrochemical reaction. Typical current efficiencies are in the range of 90%, which means that 90% of the current applied is absolutely required for the zinc reduction reaction. The electricity provides no desirable fuel effects, but is rather a necessary ingredient to effect the desired reaction.

The electrolytic production of zinc requires about 4500 kilowatt-hours per ton of zinc. The economics of zinc production facilities depend very heavily on the price of electricity, which represents about 1/3 of the total direct cost of producing zinc metal from zinc concentrate. Most new facilities are specifically being sited in areas where inexpensive hydro or nuclear power is available because of the significance of electricity cost on the overall economics.

IMPACT OF PROPOSED BTU TAX ON BIG RIVER ZINC CORPORATION

We at Big River strongly support Congress' efforts to decrease the federal budget deficit. However, we in no way can support the type of general Btu taxes proposed to date. At a minimum, any such proposed tax must exclude electricity efficiently used in the electrolytic production of critical metals such as zinc, aluminum, and magnesium; otherwise, the net result will be the devastation of these industries and the loss of revenue to the U.S. government.

We produce a critical commodity, which is sold based on worldwide prices (London Metal Exchange). We cannot pass U.S. tax increases to our customers. We use the most modern process technology, the electrolytic process, to produce that commodity. The largest single direct production cost using the electrolytic process is electricity.

One third of our overall direct plant operating costs are for electricity. That electricity is not used as a fuel source but is, rather, used in the reaction for the electrochemical recovery of zinc. Current efficiency for that deposition reaction is about 90%. Since the last

energy crisis in the 1970's, we have systematically decreased energy use by 12%. There is little room for improvement based on the theoretical requirements of the recovery reaction.

Early indications which we have received suggest that the proposed Btu tax would increase our cost for electricity by 10-20%. This would increase our overall cost to produce zinc metal by \$20-\$25/ton.

The zinc industry operates on very low margins. Prices cycle markedly, with extended periods at or below break-even costs, without even including debt service or amortization. Our industry is once again in such a period, as evidenced by the quote of Heinz Schimmelbusch, Chairman of Metall Mining Corporation, one of the world's largest zinc and other base metal producers:

"There is not one company (zinc producer) in Europe which is in a reasonable profitability position and some of the smelters have to make investment decisions to come in compliance with environmental permits." (Reuters 4 May 1993)

The situation is no different in the U.S. If the proposed general Btu energy tax is adopted, the U.S. zinc industry will be put at a large competitive disadvantage to foreign zinc producers. At times such as these, the U.S. producers will be even more hard pressed to survive. The jobs of U.S. workers are at risk.

The U.S. zinc industry has already been decimated. I urge Congress -- please give the few of us remaining a chance!

ATTACHMENT I

U.S. IMPORTS OF REFINED ZINC (thousand metric tons)

| Export Country | 1984 | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | 1991 | 1992 |
|---------------------|------|------|------|------|------|------|------|------|------|
| Canada | 340 | 384 | 349 | 361 | 428 | 436 | 344 | 390 | 436 |
| Mexico | 56 | 54 | 52 | 49 | 61 | 71 | 72 | 57 | 51 |
| Total North America | 396 | 438 | 401 | 410 | 489 | 507 | 416 | 447 | 487 |
| Australia | 23 | 30 | 41 | 50 | 25 | 43 | 43 | 20 | 40 |
| Belgium | 3 | 1 | 0 | 10 | 17 | 3 | 6 | 0 | 0 |
| Finland | 16 | 20 | 23 | 18 | 15 | 24 | 17 | 14 | 25 |
| France | 13 | 5 | 6 | 10 | 9 | 8 | 2 | 0 | 0 |
| Germany | 28 | 12 | 10 | 15 | 7 | 4 | 2 | 0 | 0 |
| Netherlands | 17 | 13 | 20 | 28 | 11 | 5 | 2 | 0 | 0 |
| Peru | 34 | 36 | 44 | 22 | 12 | 34 | 23 | 23 | 54 |
| Spain | 17 | 17 | 49 | 55 | 55 | 26 | 24 | 21 | 33 |
| United Kingdom | 6 | 7 | 6 | 4 | 4 | 1 | 1 | 1 | 1 |
| Zaire | 32 | 12 | 16 | 15 | 21 | 13 | 10 | 3 | 3 |
| Other | 47 | 20 | 51 | 69 | 52 | 15 | 32 | 13 | 27 |
| Total Outside N.A. | 236 | 173 | 266 | 296 | 228 | 176 | 162 | 95 | 183 |
| TOTAL U.S. IMPORTS | 632 | 611 | 667 | 706 | 717 | 683 | 578 | 542 | 670 |

Note: 1992 data is extrapolated from 8 month's data.

ZINC

ATTACHMENT II

TABLE 45

WESTERN WORLD : SUPPLY AND DEMAND

| | Thousand Metric Tons | | | | | | | | | |
|---|----------------------|------|------|------|------|------|------|------|------|------|
| | 1960 | 1961 | 1962 | 1963 | 1964 | 1965 | 1966 | 1967 | 1968 | 1969 |
| Concentrates (metal content by analysis): | | | | | | | | | | |
| Production | 2630 | 2703 | 2803 | 2852 | 3219 | 3470 | 3632 | 3928 | 4015 | 4231 |
| Europe | 550 | 573 | 562 | 569 | 580 | 567 | 595 | 638 | 706 | 759 |
| Canada | 390 | 402 | 455 | 451 | 667 | 826 | 950 | 1130 | 1166 | 1170 |
| Mexico | 271 | 269 | 251 | 240 | 236 | 225 | 219 | 241 | 240 | 253 |
| Peru | 178 | 190 | 204 | 217 | 263 | 283 | 316 | 339 | 324 | 334 |
| United States | 434 | 463 | 504 | 528 | 573 | 609 | 571 | 548 | 528 | 551 |
| Japan | 157 | 168 | 197 | 198 | 716 | 721 | 254 | 263 | 264 | 269 |
| Australia | 295 | 293 | 310 | 321 | 319 | 326 | 342 | 374 | 385 | 461 |
| Other Countries | 355 | 345 | 325 | 328 | 365 | 413 | 385 | 395 | 402 | 434 |
| Net exports to Socialist Countries | -20 | -17 | -27 | -57 | -71 | -57 | -79 | -46 | -33 | -10 |
| Direct use for zinc oxide | -82 | -90 | -94 | -97 | -98 | -113 | -117 | -106 | -115 | -117 |
| Balance available for smelting/refining | 2528 | 2596 | 2682 | 2698 | 3050 | 3300 | 3476 | 3776 | 3867 | 4104 |
| Slab Zinc: | | | | | | | | | | |
| Production | 2438 | 2575 | 2659 | 2754 | 2965 | 3138 | 3311 | 3302 | 3707 | 4082 |
| Europe | 919 | 966 | 925 | 924 | 969 | 1004 | 1043 | 1016 | 1185 | 1351 |
| Canada | 237 | 243 | 254 | 258 | 306 | 375 | 347 | 368 | 387 | 423 |
| United States | 786 | 816 | 851 | 864 | 931 | 978 | 1005 | 918 | 999 | 1008 |
| Japan | 187 | 219 | 254 | 297 | 325 | 376 | 450 | 520 | 609 | 717 |
| Australia | 122 | 141 | 171 | 183 | 188 | 202 | 203 | 202 | 213 | 253 |
| Other Countries | 185 | 188 | 204 | 233 | 246 | 255 | 263 | 278 | 314 | 330 |
| Consumption | 2463 | 2589 | 2714 | 2902 | 3202 | 3289 | 3440 | 3389 | 3731 | 4049 |
| Europe | 1126 | 1158 | 1141 | 1180 | 1284 | 1277 | 1277 | 1267 | 1398 | 1560 |
| United States | 790 | 838 | 929 | 996 | 1089 | 1221 | 1285 | 1129 | 1221 | 1252 |
| Japan | 189 | 234 | 243 | 305 | 364 | 330 | 389 | 462 | 527 | 609 |
| Other Countries | 358 | 359 | 401 | 421 | 463 | 461 | 489 | 531 | 585 | 628 |
| Net imports from Socialist Countries | 82 | 115 | 111 | 90 | 131 | 120 | 110 | 90 | 77 | 89 |
| Deliveries to (-)/ releases from (+) National Stockpiles: | | | | | | | | | | |
| U.S.A. | -1 | -2 | -1 | - | +68 | +149 | +91 | +13 | +34 | +17 |
| Balance | +56 | +99 | +55 | -58 | -38 | +118 | +72 | +16 | +87 | +139 |
| Reported Metal Stocks (at end of period): | | | | | | | | | | |
| Producers | 316 | 305 | 328 | 230 | 199 | 212 | 26 | 301 | 270 | 320 |
| Consumers | 125 | 154 | 133 | 147 | 177 | 209 | 185 | 166 | 168 | 182 |
| Merchants | 5 | 8 | 7 | 9 | 9 | 10 | 10 | 8 | 8 | 8 |
| L.M.E./Comex | 2 | 11 | 9 | 4 | 5 | 2 | 3 | 4 | 6 | 9 |
| Total | 448 | 478 | 477 | 392 | 390 | 433 | 461 | 479 | 452 | 519 |

TABLE 45 (Continued)

WESTERN WORLD : SUPPLY AND DEMAND

Thousand Metric Tons

| | 1970 | 1971 | 1972 | 1973 | 1974 | 1975 | 1976 | 1977 | 1978 | 1979 |
|--|------|------|------|------|------|------|------|------|------|------|
| Concentrates (metal content by analysis): | | | | | | | | | | |
| Production | 4333 | 4339 | 4458 | 4544 | 4534 | 4510 | 4574 | 4854 | 4694 | 4610 |
| Europe | 753 | 735 | 736 | 751 | 824 | 796 | 854 | 935 | 1039 | 1056 |
| Canada | 1253 | 1270 | 1271 | 1351 | 1237 | 1229 | 1147 | 1300 | 1245 | 1204 |
| Mexico | 266 | 265 | 272 | 271 | 262 | 240 | 262 | 266 | 246 | 251 |
| Peru | 332 | 353 | 418 | 434 | 420 | 405 | 464 | 476 | 458 | 491 |
| United States | 532 | 501 | 477 | 477 | 498 | 468 | 483 | 448 | 333 | 294 |
| Japan | 280 | 294 | 281 | 264 | 241 | 254 | 260 | 276 | 275 | 243 |
| Australia | 447 | 417 | 472 | 441 | 429 | 468 | 432 | 451 | 434 | 487 |
| Other Countries | 470 | 504 | 531 | 555 | 623 | 650 | 672 | 702 | 664 | 584 |
| Net exports to Socialist Countries | -18 | -70 | -92 | -49 | -13 | -44 | -91 | -189 | -183 | -168 |
| Direct use for zinc oxide | -116 | -111 | -110 | -130 | -129 | -95 | -103 | -101 | -105 | -100 |
| Balance available for smelters/ refineries | 4199 | 4158 | 4256 | 4365 | 4392 | 4381 | 4380 | 4564 | 4406 | 434 |
| Slab Zinc | | | | | | | | | | |
| Production | 3971 | 3779 | 4104 | 4261 | 4371 | 3764 | 4118 | 4283 | 4304 | 4719 |
| Europe | 1375 | 1268 | 1461 | 1575 | 1718 | 1472 | 1594 | 1716 | 1658 | 1837 |
| Canada | 418 | 373 | 476 | 533 | 438 | 426 | 472 | 495 | 495 | 580 |
| United States | 866 | 769 | 641 | 605 | 575 | 450 | 515 | 454 | 442 | 526 |
| Japan | 681 | 720 | 809 | 844 | 851 | 698 | 742 | 778 | 768 | 789 |
| Australia | 268 | 266 | 304 | 306 | 284 | 200 | 249 | 256 | 294 | 310 |
| Other Countries | 363 | 383 | 413 | 398 | 505 | 518 | 546 | 584 | 647 | 677 |
| Consumption | 3898 | 3974 | 4436 | 4839 | 4551 | 3532 | 4189 | 4263 | 4654 | 4761 |
| Europe | 1521 | 1501 | 1655 | 1813 | 1767 | 1320 | 1554 | 1590 | 1697 | 1721 |
| United States | 1074 | 1137 | 1286 | 1364 | 1167 | 839 | 1028 | 998 | 1112 | 1057 |
| Japan | 638 | 647 | 706 | 814 | 705 | 565 | 721 | 717 | 733 | 779 |
| Other Countries | 665 | 689 | 789 | 848 | 912 | 810 | 886 | 958 | 1112 | 1204 |
| Net exports to (-)/ Imports from (+) | | | | | | | | | | |
| Socialist Countries | +81 | +130 | +133 | +167 | +84 | +60 | +40 | +39 | -29 | -51 |
| Deliveries to (-)/ Releases from (+) | | | | | | | | | | |
| National Stockpiles | | | | | | | | | | |
| U.S.A. | +20 | +2 | +153 | +247 | +259 | +5 | +1 | +1 | +2 | - |
| Japan | - | - | - | - | - | - | -12 | -51 | -82 | +5 |
| Balance | +174 | -63 | -46 | -164 | +163 | +297 | -42 | +9 | -459 | -58 |
| Reported Metal Stocks (at end of period): | | | | | | | | | | |
| Producers | 485 | 433 | 336 | 244 | 385 | 797 | 715 | 859 | 463 | 552 |
| Consumers | 171 | 156 | 209 | 200 | 328 | 223 | 218 | 173 | 208 | 199 |
| Merchants | 13 | 9 | 6 | 5 | 32 | 95 | 117 | 97 | 90 | 69 |
| L.M.E./Co. ex | 13 | 16 | 35 | 8 | 14 | 70 | 90 | 65 | 72 | 48 |
| Total | 682 | 614 | 586 | 457 | 759 | 1185 | 1140 | 1194 | 833 | 868 |

ZINC

TABLE 45 (Continued)

WESTERN WORLD : SUPPLY AND DEMAND

| | Thousand Metric Tons | | | | | | | | |
|--|----------------------|------|------|------|------|------|------|------|------|
| | 1980 | 1981 | 1982 | 1983 | 1984 | 1985 | 1986 | 1987 | 1988 |
| Concentrates (metal content by analysis): | | | | | | | | | |
| Production | 4519 | 4459 | 4807 | 4817 | 5099 | 5152 | 5090 | 5379 | 5106 |
| Europe | 1106 | 976 | 1004 | 1061 | 1129 | 1138 | 1082 | 1089 | 1065 |
| Canada | 1059 | 1096 | 1189 | 1070 | 1207 | 1172 | 1291 | 1504 | 1348 |
| Mexico | 243 | 216 | 251 | 266 | 304 | 292 | 278 | 271 | 271 |
| Peru | 488 | 497 | 507 | 553 | 555 | 583 | 598 | 612 | 485 |
| United States | 349 | 343 | 330 | 293 | 278 | 252 | 221 | 233 | 256 |
| Japan | 238 | 242 | 251 | 256 | 253 | 253 | 222 | 166 | 147 |
| Australia | 463 | 485 | 633 | 663 | 653 | 713 | 665 | 738 | 739 |
| Other Countries | 573 | 604 | 642 | 655 | 720 | 749 | 733 | 766 | 795 |
| Net exports to Socialist Countries | -137 | -107 | -119 | -14 | -176 | -137 | -101 | -103 | -75 |
| Direct use for zinc oxide | -70 | -70 | -50 | -50 | -64 | -69 | -30 | -15 | -5 |
| Balance available for smelting/ refining | 4312 | 4282 | 4638 | 4603 | 4859 | 4946 | 4959 | 5261 | 5026 |
| Slab Zinc | | | | | | | | | |
| Production | 4478 | 4556 | 4330 | 4645 | 4892 | 4996 | 4854 | 5055 | 5236 |
| Europe | 1843 | 1846 | 1771 | 1871 | 1947 | 1968 | 1990 | 2089 | 2147 |
| Canada | 592 | 619 | 512 | 617 | 683 | 692 | 571 | 610 | 703 |
| United States | 570 | 393 | 303 | 305 | 331 | 334 | 316 | 344 | 330 |
| Japan | 735 | 670 | 662 | 701 | 754 | 740 | 708 | 666 | 678 |
| Australia | 306 | 301 | 296 | 303 | 306 | 293 | 308 | 312 | 302 |
| Other Countries | 632 | 727 | 786 | 848 | 871 | 969 | 961 | 1034 | 1076 |
| Consumption | 4491 | 4422 | 4236 | 4556 | 4704 | 4745 | 4885 | 5030 | 5258 |
| Europe | 1733 | 1611 | 1563 | 1645 | 1683 | 1665 | 1703 | 1731 | 1831 |
| United States | 879 | 935 | 801 | 934 | 980 | 962 | 998 | 1052 | 1089 |
| Japan | 752 | 699 | 703 | 771 | 774 | 780 | 753 | 729 | 774 |
| Other Countries | 1127 | 1177 | 1169 | 1206 | 1267 | 1338 | 1431 | 1518 | 1564 |
| Net exports to (-)/ imports from (+) | | | | | | | | | |
| Socialist Countries | -17 | -64 | -154 | -238 | -245 | -249 | -45 | +13 | -43 |
| Deliveries to (-)/ Releases from (+) | | | | | | | | | |
| National Stockpiles: | | | | | | | | | |
| U.S.A. | +4 | +1 | - | - | +4 | - | - | - | - |
| Japan | +22 | +32 | +25 | +57 | - | - | - | - | - |
| Balance | -4 | +103 | -35 | -92 | -53 | +2 | -76 | +38 | -65 |
| Reported Metal Stocks (at end of period): | | | | | | | | | |
| Producers | 499 | 564 | 503 | 345 | 420 | 409 | 432 | 367 | 309 |
| Consumers | 161 | 163 | 153 | 181 | 156 | 137 | 132 | 130 | 149 |
| Merchants | 40 | 74 | 52 | 45 | 21 | 29 | 32 | 26 | 20 |
| L.M.E./Comex | 87 | 74 | 92 | 97 | 29 | 31 | 19 | 45 | 40 |

Table 26

Zinc: Current Trends: Western World: Supply and Demand⁽¹⁾
 Zinc: Tendances Actuelles: Monde occidental: Approvisionnement et demande⁽¹⁾

Thousand metric tons

| | Annual Totals: | | | | | 1992 | | | | | | |
|--|----------------|------|------|------|------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| | 1988 | 1989 | 1990 | 1991 | 1992 | 1991 | 1992 | 1992 | 1992 | 1992 | 1992 | 1992 |
| | | | | | | Apr- Jun | Jul- Sep | Oct- Dec | Jan- Mar | Apr- Jun | Jul- Sep | Oct- Dec |
| Concentrates (Zinc content): | | | | | | | | | | | | |
| Production | 5051 | 5094 | 5382 | 5586 | 5592 | 1396 | 1395 | 1426 | 1413 | 1401 | 1386 | 1392 |
| Europe | 1065 | 998 | 950 | 924 | 779 | 235 | 220 | 238 | 215 | 196 | 179 | 189 |
| Canada | 1347 | 1216 | 1203 | 1157 | 1312 | 277 | 291 | 321 | 327 | 332 | 327 | 326 |
| Mexico | 288 | 284 | 307 | 317 | 328 | 90 | 75 | 80 | 65 | 86 | 87 | 90 |
| Peru | 485 | 598 | 584 | 623 | 609 | 162 | 161 | 154 | 149 | 149 | 151 | 160 |
| United States | 256 | 288 | 543 | 547 | 549 | 141 | 149 | 117 | 147 | 128 | 150 | 124 |
| Japan | 147 | 132 | 127 | 133 | 135 | 34 | 33 | 33 | 34 | 33 | 33 | 35 |
| Australia | 739 | 811 | 884 | 1048 | 1013 | 245 | 269 | 273 | 251 | 253 | 263 | 246 |
| Other Countries | 724 | 767 | 784 | 837 | 867 | 212 | 197 | 210 | 225 | 224 | 196 | 222 |
| Net exports to (-)/ imports from (+) Eastern European and Socialist Countries | -75 | -50 | -42 | -11 | ... | 1 | 1 | -7 | -11 | -19 | -24 | ... |
| Direct use for zinc oxide | 5 | 4 | 4 | 4 | ... | 1 | 1 | 1 | 1 | 1 | 1 | ... |
| Balance available for smelting/ refining | 4971 | 5040 | 5336 | 5571 | ... | 1396 | 1395 | 1418 | 1401 | 1381 | 1361 | ... |
| Slab Zinc Production: | | | | | | | | | | | | |
| Primary | 4940 | 4905 | 4842 | 5015 | ... | 1256 | 1239 | 1310 | 1282 | 1252 | 1213 | ... |
| Secondary | 299 | 310 | 334 | 370 | ... | 92 | 93 | 92 | 89 | 89 | 92 | ... |
| Total | 5239 | 5215 | 5176 | 5385 | 5398 | 1348 | 1332 | 1402 | 1371 | 1341 | 1305 | 1381 |
| Europe | 2150 | 2125 | 2144 | 2194 | 2185 | 538 | 552 | 569 | 558 | 543 | 529 | 555 |
| Canada | 703 | 670 | 592 | 661 | 671 | 163 | 166 | 173 | 171 | 161 | 166 | 173 |
| United States | 330 | 358 | 358 | 377 | 394 | 95 | 90 | 97 | 99 | 98 | 98 | 99 |
| Japan | 678 | 665 | 687 | 731 | 730 | 189 | 167 | 192 | 187 | 190 | 164 | 189 |
| Australia | 302 | 294 | 303 | 326 | 332 | 84 | 80 | 82 | 76 | 88 | 86 | 82 |
| Other Countries | 1076 | 1103 | 1092 | 1096 | 1086 | 279 | 277 | 289 | 280 | 261 | 262 | 283 |
| Consumption | 5264 | 5191 | 5219 | 5403 | 5365 | 1351 | 1326 | 1398 | 1341 | 1381 | 1314 | 1329 |
| Europe | 1854 | 1846 | 1897 | 2005 | 1938 | 520 | 465 | 516 | 496 | 522 | 448 | 472 |
| United States | 1089 | 1060 | 992 | 933 | 1029 | 213 | 239 | 258 | 263 | 251 | 263 | 252 |
| Japan | 774 | 769 | 814 | 845 | 786 | 214 | 212 | 209 | 190 | 197 | 194 | 205 |
| Other Countries | 1547 | 1516 | 1516 | 1620 | 1612 | 404 | 410 | 415 | 392 | 411 | 409 | 400 |
| Net exports to (-)/ imports from (+) Eastern European and Socialist Countries | -43 | -42 | 39 | 104 | ... | 29 | 26 | 28 | 48 | 65 | 66 | ... |
| Balance | -68 | -18 | -4 | 86 | ... | 26 | 32 | 32 | 78 | 25 | 57 | ... |
| Reported Metal Stocks (at end of period): | | | | | | | | | | | | |
| Producers | 309 | 350 | 338 | 350 | 374 | 319 | 324 | 350 | 353 | 343 | 348 | 374 |
| Consumers | 260 | 247 | 246 | 259 | 244 | 254 | 256 | 259 | 244 | 250 | 252 | 244 |
| Merchants | 18 | 25 | 22 | 18 | 18 | 18 | 12 | 18 | 21 | 16 | 13 | 18 |
| L.M.E./Comex | 41 | 81 | 55 | 152 | 488 | 117 | 150 | 152 | 222 | 331 | 367 | 488 |
| Total | 628 | 703 | 661 | 779 | 1124 | 708 | 742 | 779 | 840 | 940 | 980 | 1124 |
| Stock Ratio ⁽²⁾ | 6 | 7 | 7 | 7 | 11 | 6.8 | 7.3 | 7.2 | 8.2 | 8.7 | 9.2 | 11.4 |

(1) Excluding Eastern European and Socialist Countries.

(2) Weeks of consumption.

CHART III - A

ZINC PRICE HISTORY

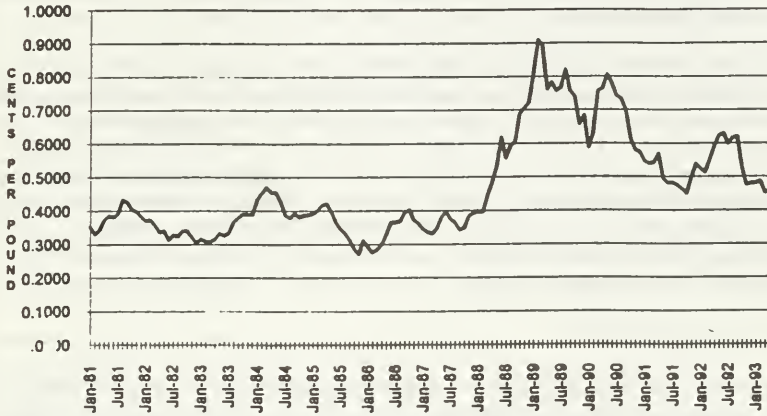
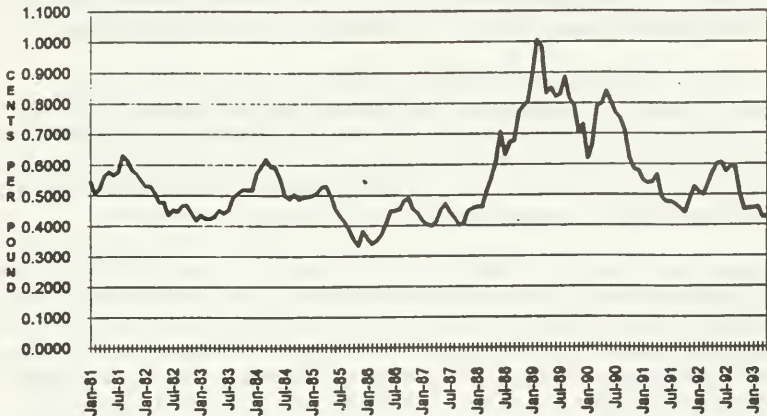


CHART III - B

ZINC PRICE HISTORY REFLECTED IN 1990 DOLLARS



STATEMENT OF THE CHEMICAL MANUFACTURERS ASSOCIATION

The Chemical Manufacturers Association (CMA) appreciates this opportunity to present its views on President Clinton's investment and deficit reduction plan, and, in particular, the proposed Btu energy tax.

CMA is a non-profit trade association. Our member companies represent more than 90 percent of the productive capacity for basic industrial chemicals in the United States. The chemical industry is a keystone U.S. manufacturing industry. Our products are vital materials for the rest of U.S. manufacturing and the future of other U.S. manufacturing is vitally important to the U.S. chemical industry. The U.S. chemical industry, despite more than a decade of fundamental restructuring, provides 1.1 million high-wage, high-tech jobs for American workers -- the kind of jobs President Clinton wants to create. Moreover, in 1992 the chemical industry was the largest U.S. exporter, accounting for \$1 out of every \$10 of U.S. goods exports.

Overview of CMA's Position

President Clinton is to be commended for supporting deficit reduction. CMA is eager to support and work for passage of a budget plan that will help to build America's economic future. Much of the debate about the President's plan concerns the relationship between spending cuts and new taxes. This is an important issue. CMA believes that additional cuts in government spending beyond those proposed by the President should be made. The President's plan, however, calls for new revenues. If, in the end, the Congress calls for new revenues, the important question then is "how can additional revenues best be raised without damage to the economy?" This statement responds to that question.

We believe that "taxing consumption changes behavior, but taxing manufacturing production kills jobs!" Accordingly, if the Congress determines that new revenues are necessary, the best alternative is adoption of the same credit method value-added tax that is already utilized by virtually all of our major competitor nations. By contrast, we believe a Btu tax and other taxes that would disadvantage U.S.-based production that must compete against foreign-based production would not be sound economic policy.

There are multiple advantages to adoption of a value-added tax as an alternative to other new taxes and as the basis for a fundamental restructuring of our tax system that would accommodate to the new realities of a global economy. A value-added tax is a fair tax. It taxes consumption of the nation's resources and adjustments can be made to make it as progressive as other taxes. Second, it can provide a major revenue source. And finally, it is one of the few taxes that is trade neutral. It will not pose a threat to U.S.-based manufacturing and other goods production and will not jeopardize the jobs of American workers.

U.S. Economic Policies Affect International Competitiveness

We are obviously at a critical point in determining our country's economic future. The policies set by this Congress will do much to decide that future. We believe that U.S. economic policies--particularly our tax policies--must recognize that we live and compete in an integrated world economy. Some of our industries--particularly, our manufacturing industries--must compete in that world economy. Our policy making should recognize that manufactured goods trade is the major means by which countries engage in international economic competition and that U.S. manufacturing bears the brunt of the nation's competition in the international economy.

To illustrate these points, we note that U.S. merchandise exports are now 7.5 percent of GDP and imports are 9.0 percent. But it is also important to recognize that about 80 percent of all of U.S. merchandise trade is in manufactured goods. Moreover, the deterioration of U.S. trade performance during the 1980s was manifested primarily in manufactured goods. Most importantly, trade in goods--not services trade--will remain the critical interaction of the U.S. economy with the world economy. The point is simply that we need to consider carefully how our domestic economic policies will affect the competitive position of U.S. manufacturing and other U.S. industries that must meet international competition.

U.S. manufacturing's record has not been strong in recent years. Over the last two decades U.S. manufacturing has had to face intensifying international competition. In the process it actually shed some 2.1 million jobs between 1981 and today. Part of this job loss reflects rising productivity in the manufacturing sector--gains essential to improved international competitiveness. But the job losses also reflect a decline in international competitiveness, a decline in which U.S. government policies have played a role. U.S. manufacturing has not regained its earlier strong competitive position. Despite large productivity gains, the manufactures trade deficit in 1992 rose by \$20 billion to \$86.7 billion. Moreover, every major forecaster projects further increases in U.S. manufactures trade deficits in the years ahead. A manufactures trade deficit of about \$100 billion in 1993 seems likely.

The Commerce Department estimates that each billion dollars of U.S. exports supports about 19,000 jobs. Eliminating a manufactures trade deficit of \$100 billion by a more competitive U.S. manufacturing sector that expanded its exports and captured a larger share of the U.S. market would create many hundreds of thousands of new manufacturing jobs.

But in the current environment manufacturing job gains do not seem likely. Widening manufactures trade deficits indicate that U.S.-based manufacturing is still not sufficiently competitive in the world economy. Even without new taxes that add to U.S. production costs, we can expect not manufacturing job gains but further manufacturing job losses.

Tax Policy and U.S. Manufacturing

Clearly, a strong, internationally competitive U.S. manufacturing sector is essential to a strong U.S. economy and to growth in U.S. living standards that compares favorably with other industrialized nations. President Clinton has frequently expressed similar views and has emphasized the need to increase investment in America to build its future competitiveness.

Tax and other government policies can have important effects on the costs of U.S. industry. Yet, notwithstanding U.S. manufacturing's existing problems and an already unfavorable competitive outlook, the President's plan has not been structured in a way that recognizes the effects of tax and other U.S. government policies on the ability of U.S.-based manufacturing to compete in U.S. and foreign markets. In the short term it will raise U.S. manufacturing's costs and further damage trade performance. And in the long term it will be a disincentive to the higher levels of investment required to enhance U.S. competitiveness.

Three key provisions of the plan will add significantly to the costs of, and will discourage investment in, U.S.-based manufacturing:

- o The proposed Btu tax would add significantly to the costs of manufacturing in the United States--over \$5 billion annually to manufacturing as a whole, \$1.2 billion of that to chemicals manufacturing costs alone.
- o Proposed changes in the tax treatment of income from royalties and licenses will further lower the returns on the R&D that have been instrumental in maintaining the international competitiveness of some of the strongest American manufacturing industries.
- o The rise in the corporate income tax rate will lower the rate of return on investment and incentives to invest, particularly investments by manufacturing companies that must face international competition.

We believe it is important that the public recognize that these new taxes cannot logically be seen as tapping "special interests." Instead, each tax will have negative effects on the international competitiveness and the profitability of U.S. companies. These effects would, unequivocally, not be in the best long term interests of members of the U.S. economy--they would hit persons at every income level. This is because each increase in the costs of U.S. manufacturing firms inevitably must be borne by individual members of the economy at all income levels. Higher costs from energy taxes translate to higher prices to consumers, lower wages to employees, U.S. jobs lost to foreign competitors, and lower profits. In turn, lower profits lead to reduced investment and to lower productivity and lower U.S. living standards than would otherwise be achieved.

CMA believes that, in a highly competitive world economy, it would not make sense to further tax our own U.S.-based manufacturing production. Again, taxing consumption changes behavior, taxing manufacturing production kills jobs! If Congress decides additional tax revenues are required, the interests of all Americans are best served by taxes levied on consumption--not by taxes on U.S.-based manufacturing. A credit invoice method value-added tax (VAT) provides a widely used and accepted means by which the costs of domestic production can be insulated from tax effects. Such a tax, used by virtually every other industrialized nation, is collected at the border on imports, rebated on exports. Accordingly, CMA believes that the Congress should reject a Btu tax that cannot be border adjusted and turn to a credit method value added tax (VAT) as a source of new revenue that may be required, and as a replacement for much of the existing tax system. From the standpoint of U.S. manufacturing, the negative effects of these three elements of the budget plan--which once enacted are likely to remain in law for an extended period--considerably outweigh the less certain and more ephemeral positive effect on interest rates that is a primary goal of deficit reduction.

The above provides an overview of CMA's reaction to the President's plan. The following offers more specific details concerning individual elements of the plan.

Proposed Btu Tax on Energy Used as Fuel for Production Process Would Seriously Harm U.S. Manufacturing.

CMA opposes energy taxes that fall heavily on the manufacturing process. Our reasoning is basic: Any tax that raises the cost of U.S.-based manufacturing relative to competition abroad damages the ability of U.S.-based manufacturers to compete in both domestic and international markets. Energy intensive industries--including steel, aluminum, pulp and paper, glass, cement, chemicals and agriculture--would be particularly hard-hit. An energy-intensive industry like the chemical industry that uses energy both as fuel and as raw materials for its production processes could be gravely wounded by unilaterally imposed energy taxes.

CMA estimates that, even when applied only to energy used to fuel production processes, the Administration's proposed Btu tax would raise U.S. manufacturing energy costs by over \$5 billion yearly. Chemicals is an energy-intensive industry. Its energy costs alone would rise by about \$1.2 billion annually with a feedstock exemption, \$2.2 billion without such an exemption. It should be noted that the \$1.2 billion is four times the \$300 million in specific chemical feedstock taxes the industry is already paying annually under Superfund.

The chemical industry produces and sells in a highly competitive market in which margins on any given transaction may be measured in cents per pound. The committee will recall that after the 1980 enactment of the Superfund chemical feedstock taxes, U.S. chemical exports declined and imports increased sharply. Moreover, after amendments in 1983 and in 1986 to provide border adjustments of the Superfund feedstock taxes, U.S. chemical exports grew rapidly and by 1992 the chemical industry was the leading U.S. exporter.

The record is unequivocal on the harm that occurred to our industry before Congress provided border adjustments for Superfund taxes. The proposed Btu tax on the energy used--even if limited to the energy used as fuel or power for our production processes--would be much more destructive to U.S. chemical trade than the Superfund tax. This is both because the Btu tax would be much more costly and because, as a practical matter, the energy tax costs embedded in finished products cannot be adjusted at the border under the General Agreement on Tariffs and Trade (GATT) or the U.S.-Canada Free Trade Agreement (CFTA).

Effective Chemical Feedstocks Exemption Essential for U.S. Chemical Industry.

The U.S. chemical industry is energy intensive. It accounts for almost 7 percent of all U.S. energy consumption. About one-half of that consumption is to power the production process; the other one-half is for feedstocks--the raw materials from which many chemicals are made.

In a highly competitive world economy, any tax on energy sources that does not include an effective, workable exemption for chemical industry feedstocks could end the international competitiveness of the U.S. chemical industry. We understand that the Administration's proposal does include an exemption from the proposed tax for all non-fuel uses, including chemical feedstocks. However, the U.S. chemical industry manufactures more than 70,000 products. Tailoring an effective exemption that would mitigate the harmful effects of the proposed energy tax on U.S. trade in these products will be difficult and will require great care.

Trade Effects of the Btu Tax

The proposed new taxes would also be directly manifested in U.S. trade performance. Energy is an important cost factor at every stage of manufacturing. A Btu tax would raise the costs of manufacturing in the United States. Higher costs of U.S.-based manufacturing will dampen exports and increase imports, with obvious negative effects on U.S. jobs.

The energy intensive chemical industry would be among those most affected. This is significant because the chemical industry has for some years been the epitome of what we all would like U.S. manufacturing to be. Chemicals is a high tech, dynamic, capital and R&D intensive industry, generating about 15 percent of all the nation's registrations of new patents. The U.S. chemical industry employs 1.1 million workers and pays wages to its production line workers that are about 30 percent above the average for U.S. manufacturing.

And it has also been internationally competitive. Chemical industry trade performance has been a particularly important positive factor in the overall U.S. trade picture. For several years chemicals has been the largest U.S. export sector, providing \$1 of each \$10 of U.S. goods exports. Exports of chemicals reached \$44 billion in 1992, more than total U.S. agricultural exports. U.S. chemical trade surpluses in the ten years ending in 1992 totaled \$122 billion.

U.S. chemicals trade performance is not invulnerable, however. Recognizing the keystone importance of a chemical industry to a nation's economy and the technology a chemical industry develops and transfers, every developing nation wants its own chemical industry. Many developing countries are building their own production capacity. Some have their own low cost sources of energy. In the face of the resulting intensifying world competition the U.S. chemicals trade surplus declined from \$18.8 billion in 1991 to only \$16.3 billion in 1992. Further slippage seems likely, even without the added burden of increased energy taxes.

The effects on U.S. trade performance from an increase in U.S. chemical production costs that will result from a Btu tax will, of course, extend far beyond U.S. chemicals trade. The costs of downstream U.S. manufacturers--and their prices--will rise to reflect the increased costs of the chemicals they use and the rise in their own energy costs. This will damage their ability to compete in U.S. and foreign markets.

The Btu Tax and Energy Independence

The Administration projects that the proposed Btu tax will have favorable effects on oil imports, reducing the oil import bill by some \$4 billion from the baseline forecast by the year 2000, a 3 percent decline from the level that would result absent a Btu tax. Such a reduction, if achieved, would be welcome but hardly a significant move away from import dependency. Moreover, whether any reduction will actually occur is, at best, highly questionable. One recognized authority, Philip Verleger, Jr. of the Institute for International Economics, believes that the proposed Btu tax may actually increase U.S. dependence on oil imports as well as the dollar value of the imports. This may occur because the tax may exert a greater negative effect on domestic oil production than it does on total U.S. consumption. And these oil import increases would be in addition to the trade balance deterioration in other products that would stem from the increased costs of U.S. manufacturing industries.

The Btu Tax and the Environment

Environmental benefits are claimed for the Btu tax but the structure and level of the Btu tax rates are such that it will actually engender little or no environmental improvement. There are potentially much more effective and efficient ways of achieving most environmental goals. The Btu tax is primarily a revenue raiser. At the proposed rates, however, it is a cumbersome, expensive tool that, although it hits some industries hard, raises relatively small amounts of total revenue. Much of the revenues would actually come from the tax on gasoline. The Administration estimates the Btu tax will, in effect, raise the price of gasoline about 9 cents per gallon. The implicit tax on gasoline will provide about forty percent of the total revenue of \$22.3 billion the Btu tax is projected to raise by 1997.

There is, however, good reason to fear that the proposed Btu tax rates are only the beginning--the thin end of the wedge--and that, over time, the rates would be increased in real terms. This is likely because, at best, the current budget plan makes only a beginning in the reduction of Federal budget deficits and because extending health coverage to all Americans may be seen as requiring additional funds. Once a new bureaucracy is created

to administer a Btu tax, there will be a natural tendency to want to use this new revenue source to generate still more funds. These tendencies will be buttressed by pressures from environmentalists who see cuts in energy consumption as an important goal. The result would be an even greater disadvantage to U.S.-based production than would result from a Btu tax at the currently proposed rates.

A Btu Tax and Industrial Efficiency

Much of the support for energy taxes seems to be based on a presumption that energy is cheap in the United States, resulting in its inefficient use. Some argue that energy taxes will, therefore, promote decreased energy consumption and increased energy efficiency with no loss--perhaps even a gain--to U.S. international competitiveness. But this perception stems primarily from the relatively low gasoline taxes in the United States. In fact, contrary to popular belief, U.S. industrial energy sources are not cheap compared to those paid by foreign industry. Gasoline is often much more heavily taxed by foreign governments but they do not impose similar taxes on industrial use of energy. Analyses of energy costs typically do not focus on industrial energy costs. In addition, international comparisons of energy costs inevitably fail to consider the added environmental costs of energy use and consumption in the United States--costs not imposed by our major trading partners.

In fact, U.S. industry cannot use or consume energy as a raw material or fuel without meeting tough, mandated pollution abatement and control standards. The costs of meeting these standards can be very high. For example, the U.S. chemical industry now pays about \$4.9 billion annually for pollution abatement and control, and by the end of the decade spending for this purpose will double to almost \$10 billion in real terms. Pollution abatement and control measures typically lower productivity and increase energy costs. Therefore, the high cost of meeting these pollution abatement and control standards must be considered as part of U.S. manufacturing's total energy costs.

Concerning the theory that an energy tax will increase energy efficiency, manufacturing firms that must compete in the world economy do not need another tax to make them more competitive. To survive in an ever more competitive world, U.S.-based manufacturing firms must improve efficiency in every aspect of their production, including energy use. The U.S. chemical industry, for example, has improved its overall energy efficiency by 43 percent over the last two decades. Instead of spurring energy efficiency, a Btu tax would drain corporate funds that would otherwise be available for R&D or to invest in new, more efficient plant and equipment. A Btu tax would be an additional handicap on, and disincentive to, investment in U.S.-based manufacturing.

A Btu Tax Would Be A Unilateral U.S. Action

Some also may argue that our competitors, particularly in the European Community (EC), will be imposing energy taxes--perhaps a carbon tax--so that we need not be concerned about a loss of U.S. competitiveness from a Btu tax. There are several responses to this argument. First, our competition is global, not just in the EC. Indeed, EC chemical production now represents only about one-fourth of the world total. Second, the Europeans have not yet instituted such a tax. Whether they will do so is problematical. Third, when and if they do institute an energy tax, they will not handicap their manufacturing industries. The various proposals that are being examined make it clear that this will be the case. And, recognizing their dependency on trade, there is every reason for them to ensure against harm to their major industries. For example Germany's chemical trade surpluses for 1990 and 1991 summed to \$33.7 billion. But just as is true of the United States, in an environment of increasing international competition

Germany's chemical trade surplus is already in jeopardy, even without new taxes. In this situation Germany's tax policy is not likely to handicap the trade performance of its chemical industry.

Again, given the disadvantages that a Btu tax would impose on U.S.-based manufacturing, it is important to recognize that there is no valid way under the General Agreement on Tariffs and Trade (GATT) or the Canadian Free Trade Agreement (CFTA) to neutralize the harmful effects of an energy or environmental tax on U.S. trade. In effect, a Btu tax--and the other new taxes on U.S.-based production that are proposed in the President's plan--would penalize U.S. exports in world markets, encourage U.S. imports, and add to a growing U.S. trade deficit.

Proposed Treatment of Royalty Payments under Technology Licensing Agreements Would Penalize U.S.-based Manufacturing.

The U.S. chemical industry has very large investments in production facilities in many foreign countries. The chemical industry is also among the leading developers of new technology and holders of patents both in the United States and worldwide. U.S. parent companies earn significant income from the engineering and technical services they provide to their overseas affiliates. In addition, the income from licensing of their technologies overseas--primarily licensing to affiliates by their U.S. parents--is an important source of the income and international competitiveness of U.S. chemical companies. U.S.-based research costs are very large and must be amortized over sales in global markets if current levels of R&D are to be maintained. Increased taxation of the earnings from licensing is hence a long term threat to the competitiveness of U.S.-based manufacturing.

The proposal to treat all income from royalties and from engineering and technical services earned from the taxpayer's active conduct of trade or business as passive income thus defies logic and lacks any coherent policy rationale. Moreover, the proposal appears destined to achieve precisely the opposite of the stated goals of the Administration's comprehensive economic plan.

Instead of stimulating job creation and providing an environment for long term growth, this proposal more likely would reduce the number of U.S.-based high tech and research jobs, while damaging the profitability of U.S. companies and the long term competitiveness of U.S.-based manufacturing. Instead of improving the domestic base for the export of U.S.-based technology, it is more likely the proposal would increase imports of technology and at the same time would increase exports of associated jobs, growth, and capital. Finally, when royalty payments are made from one related party to another, the proposal arbitrarily differentiates royalties from other types of income, such as dividends and income, received from related parties.

Present Corporate Tax Rates Maintain U.S. International Competitiveness.

The Administration's economic stimulus program should seek to maintain the competitiveness of U.S.-based manufacturers and the American jobs they provide. U.S. tax rate changes will affect manufacturing's international competitiveness. Since 1986, virtually all major trading nations have reduced their own corporate and business tax rates to at or near U.S. levels. Raising U.S. income tax rates under these circumstances would only increase the tax burden of U.S. exports in world markets and the corresponding tax advantage of imported products in the United States. The most important provision for long term economic growth would be to retain the corporate income tax rates enacted in the 1986 Tax Reform Act.

New policies and programs for economic stimulus should not be paid for by increasing these marginal income tax rates.

Revise Alternative Minimum Tax for Effective Economic Stimulus.

CMA commends the Administration for its efforts to improve the corporate alternative minimum tax ("AMT"), especially with respect to the treatment of depreciation. We would suggest that you further revise the AMT to provide additional stimulus to the economy. A majority of large corporations especially capital intensive manufacturers are now in a minimum tax position. The Administration's proposed incremental investment tax credit could be used to reduce the AMT tax burden. After first meeting the restricted qualifications to use the proposed temporary incremental investment tax credit, the credit could offset a maximum of only 25 percent of AMT liability. If the temporary tax credit is to provide a significant incentive to corporate AMT taxpayers, much more reform is needed.

The AMT burden is especially harmful to the competitiveness of U.S. manufacturing when that liability arises from expenditures to meet mandated Congressional environmental standards that do not produce income. Many of our members now pay the AMT because they have made high capital expenditures to meet government mandated pollution standards while their earnings and taxable income are low. Ironically, they and other manufacturers pay the additional AMT tax penalty when they can least afford it. Sound public policy dictates that these taxpayers who are investing to comply with mandated environmental standards should not bear the additional economic burden of the AMT.

Conclusion

It has often been noted that small businesses have been responsible for most of the nation's job creation in recent years. This has provided a rationale for granting them tax incentives. CMA welcomes this attention to the problems of small businesses. However, most small businesses are in various kinds of services industries, ranging from restaurants to computer software and cleaning services. Many of them provide their services to manufacturing firms but very few directly face international competition.

But U.S. manufacturing--much of which is "big business"--does have to face international competition. And in a world economy in which that competition becomes tougher every year, smaller and smaller additions to the cost of production can tilt the competitive balance and the location of manufacturing production.

Popular attitudes often seem to favor "small business" but look less kindly on big business. Yet, for the most part it is the large firms that pay the higher wages, provide their employees costly health, pension, and other benefits, bear the brunt of international competition, and provide the vast majority of U.S. exports. Small businesses play only a small role in international trade. But small businesses in the United States cannot achieve their full potential if U.S. manufacturing fails in international competition. Moreover, the debt and equity instruments of the larger companies are the major holdings of private sector pension funds. Lower corporate profits mean less secure pension funds. Rising corporate profits enhance the ability of retirement funds to meet their obligations to retirees.

The point of this testimony is a simple one. An effective U.S. economic recovery plan that looks to the long term must preserve and enhance--not impair--the competitiveness of U.S.-based manufacturing and the American jobs it provides. Again, taxing consumption changes behavior. But taxing manufacturing production kills jobs! Providing short term economic incentives to some sectors of the economy at the expense of others will not help the economy as a whole. Indeed, paying for these incentives by increasing Federal corporate income tax rates or by imposing a new energy tax or environmental tax would be worse than no action.

If Congress decides additional revenues are required, our trading partners around the world have demonstrated that a credit method value-added tax can produce needed revenue without imposing additional burden on international trade. A credit method value-added tax is also one of the few tax proposals valid under GATT that could increase U.S. saving and would increase the share of U.S. government costs borne by imported products and manufactures.

CMA does not ask for special favors for U.S. manufacturing. Instead, it asks only that government not disadvantage U.S.-based manufacturing in its ever more difficult struggle to remain competitive in the world economy.

STATEMENT OF THE DOMESTIC PETROLEUM COUNCIL

The Domestic Petroleum Council (DPC) is pleased that the Administration has modified its original Btu tax proposal to take into account several major concerns of its members, the largest of the nation's independent producers of crude oil and natural gas. Moving the collection point of the tax closer to the point that oil and gas are consumed as fuels is encouraging. DPC appreciates the willingness of the Administration to listen to the concerns of independent oil and gas producers and looks forward to its continuation.

DPC's members still have a number of outstanding concerns with the details of the Administration's Btu tax proposal, and we continue to believe that imposition of an import fee on imported oil is a better way of achieving the Administration's goals. The most serious of DPC's concerns with the Btu proposal and our recommendations on how they may be resolved are listed below:

1. **There remains a significant question as to whether the tax on natural gas will ultimately be passed through to the consumer.** Although the tax is described as a consumption tax, there is no mechanism to assure that local distribution companies (LDCs) will pass the tax through to consumers. Some or all of the tax may be recovered by passing it back to the producer in the form of lower wellhead prices. If passed back to the producer, the tax will further erode producer profits from the sale of natural gas and may cause more wells to be plugged and abandoned.

Solution: Ensure that the tax is imposed on the consumption of natural gas by moving the imposition of the tax from the LDC to the consumer, with the collection and payment of the tax by the LDC.

2. **Taxing all refined petroleum products at the same rate disproportionately places the highest tax on the lowest-valued products.** This occurs because the lowest-valued products, such as residual fuel oil, are highest in Btu value. Refiners will not be able to pass all of this tax through to the consumer of these products and, as a result, can be expected to recover the tax by lowering the price they pay producers for crude oil. The

Administration's shifting the tax from crude oil entering the refinery to refined products leaving the refinery is an improvement but does not alleviate this concern.

Solution: Allocate the tax on refined petroleum products to reflect the value of the products relative to each other and to other comparable non-petroleum products. For example, one way this could be done would be to eliminate the supplemental tax on the lower-valued products and increase the tax by a corresponding amount on the higher-valued products, such as gasoline and diesel fuel. Taxing the lower-valued products at the base rate is consistent with the treatment given coal, a fuel which similarly sells for less per Btu.

3. **Collecting the tax on natural gas liquids (NGLs) from owners and operators of natural gas processing plants needlessly increases the cost of compliance for both the industry and the IRS.** Approximately 75% of NGLs are ultimately used as feedstock and would be exempt from the tax. But by placing the burden of collection on the processing plants before it can be determined how much of their sales will be exempt from the tax, the Administration proposal will require the collection of tax on these tax-exempt NGLs and necessitate a massive refund scheme. DPC doubts whether a refund scheme can be designed that will ensure that the owners of processing plants and natural gas producers will not bear the burden of at least a portion of this tax.

Solution: Move the point of collection on NGLs to the point at which they are odorized and sold for commercial use. Virtually all NGLs that are used as fuel and thus subject to the tax must be odorized for safety under State laws. Imposition of the tax should be on the purchaser at the plant or terminal delivery point. Collection of the tax at this point will move the incidence of the tax closer to the point of consumption, eliminate uncertainty as to ultimate use and significantly reduce the cost of compliance.

4. **The exemption for fuel used on the premises for additional extraction should be clarified.** Imposing the tax on the oil and gas producer's use of energy that may be produced off-site or used off-site for the production of oil and gas will increase the producer's cost of production, thus causing marginally economic oil and gas wells to be abandoned. Fuels may be collected from other wells within a unit or lease and may be commingled or burned for use in extracting additional oil and gas. Its use would be taxable under a strict interpretation of on the premises extraction definition. This is contrary to the Administration's goal of reducing dependence on foreign sources of energy. DPC appreciates the Administration's modification exempting fuel produced on-site and

used on-site, but the exemption could be interpreted in an unduly restrictive manner and should be clarified to include energy produced or used off-site.

Solution: Exempt all energy used in the production of oil or natural gas from the tax. For example, for natural gas production, all energy used by the producer prior to the pipeline receipt point should be exempt from the tax.

5. **Taxing natural gas used to transport natural gas will result in a tax on natural gas production which producers may not be able to pass through.** Significant volumes of producers' natural gas are used to assure pipeline delivery to natural gas consumers. These uses account for the so-called "shrinkage" which the Administration's proposal would tax. If this tax is collected from producers, they would not be able to pass all of it through to their purchasers, their costs of production would thereby significantly increase and they would be forced to abandon marginally economic wells.

Solution: Eliminate the tax on natural gas used to transport natural gas.

6. **There is no policy justification for exempting ethanol or methanol from the tax while taxing fuels which compete with it.** Carving out an exemption for ethanol or methanol would give producers of these fuels an unfair competitive advantage over natural gas producers who produce compressed natural gas or liquified petroleum gas which compete with them. Fuels which compete with other fuels subject to the tax should not be exempted.

Solution: Eliminate the Administration's proposed exemption for ethanol and methanol.

DPC continues to believe that an import fee on all imported oil is a better way of achieving the Administration's goal of reducing imports of foreign oil and encouraging energy conservation. An oil import fee has a number of advantages. It would:

- * help create jobs in America;
- * aid in the reduction of the federal deficit;
- * increase severance and royalty income to federal and state governments;
- * encourage conservation;
- * help arrest the decline in U.S. oil and natural gas production;
- * help to reduce oil imports and the resulting trade imbalance;

- * reduce the exposure to tanker spills; and,
- * maintain the domestic exploration and production industry's ability to find and produce U.S. energy supplies.

If tax revenues are to be raised through a consumption tax, DPC recommends a broader-based tax that would spread the burden more evenly and thinly throughout the economy. Additionally, DPC strongly urges that the tax on domestic natural gas, domestic natural gas liquids and domestic crude oil be imposed at lower rates than coal and imported hydrocarbons, both refined and unrefined, to reflect the added environmental and security costs of importing and using these fuels.

STATEMENT OF THE ELECTRIC GENERATION ASSOCIATION

The Electric Generation Association ("EGA") is a national trade association representing non-utility power producers and qualifying facilities (referred to in this statement jointly as "IPPs") and suppliers of goods and services to the competitive wholesale electric generation industry. Our companies represent a dynamic, fast growing industry that in 1992 accounted for approximately 67% of all new electric generation capacity brought on line in the United States. Our members provide their utility customers, and hence the general public, with safe, low-cost, environmentally sensitive, and reliable wholesale electricity.

Our statement is in three parts. Part I presents the EGA's support for the Administration's goal of deficit reduction. The EGA recognizes the revenue raising and energy conservation objectives of a fuel tax and seeks only to insure that such a tax be applied in a fair and administrable way, consistent with conservation goals. EGA strongly believes that the fairest and most equitable tax for both utilities and IPPs, and the soundest tax for achieving conservation goals, is a fuel tax levied on the retail consumer of electricity. This is particularly important for IPPs that have entered into long-term commitments which will not permit the full passthrough of the fuel tax in the purchase price of electricity.

Part II of our statement briefly describes the contractual and financing relationships that bind IPPs and their electric utility customers. Part III of our statement comments on the Administration's energy tax proposal as modified by the Secretary of the Treasury on April 1, 1993, and offers specific recommendations for implementing the Administration's proposed grandfather relief for the IPP industry.

I.

The EGA supports and applauds President Clinton's commitment to reducing the federal budget deficit. We too believe that reducing the federal deficit and stimulating economic growth should be the nation's top priority. The EGA went on record early on in support of President Clinton's call for "shared sacrifice" to reduce the deficit for the economic well-being of the country. Reducing the deficit, maintaining low interest rates, and increasing investment opportunities are essential means to stimulate economic growth in the nation as a whole and for the electric power industry specifically.

The EGA understands that an energy tax based on fuel consumption will be an important feature of deficit reduction legislation. Such a tax should be broadly applied to fossil fuels and other energy sources used in the generation of electricity. The energy tax should also be applied in a manner that most effectively promotes energy conservation, is borne equitably across all fuels and regions of the country, and does not disrupt existing markets solely on the basis of ownership of projects. The Secretary of the Treasury in his April 1, 1993 statement accompanying the modified Administration proposal, emphasized the primacy of these principles and acknowledged that "if the tax is to effectively promote energy conservation, it must be borne by the ultimate consumer."

An energy tax imposed on the retail consumer of electricity and natural gas would be the most efficient energy tax for purposes of promoting energy conservation, as well as being the tax solution which is the most equitable and administrable for utilities, IPPs and the Internal Revenue Service. While not preferable, the EGA would not oppose the Administration's proposed upstream collection of the energy tax if it were designed and implemented in a manner which ensures that the tax will be successfully passed through to the ultimate consumer, will promote conservation, be consistent with IPPs' existing firm contracts and ensure continuing market-based competition.

The Administration's modified proposal recognizes that many IPPs face substantial constraints, many of which are contractual, in their ability to pass through the energy tax to utility purchasers, and hence, to retail consumers. Unless an effective grandfather rule is crafted for IPPs operating under existing commitments, in many cases the proposed energy tax would be borne entirely by IPPs and would not be reflected in the price of electricity paid by retail consumers. Such a result would be both unfair to the IPPs, antithetical to the objective of promoting energy conservation, and potentially threatening to the utilities that rely on IPPs for their resource needs. Part II of this statement explains the serious financial consequences that many IPPs will face in the absence of an effective grandfather rule. Part III of our statement advocates means for implementing fair and efficient relief for IPPs that is consistent with the objectives of the Administration's modified proposal.

II.

The IPP industry is a young entrant into the nation's electric energy system. Beginning with the adoption of the Public Utility Regulatory Policies Act of 1978 ("PURPA") and continuing with the recent enactment of the Energy Policy Act of 1992, Congress has sought to promote competition in the production of electricity by encouraging the growth and economic viability of IPPs as competitive suppliers of new electricity generation.

Independent power differs fundamentally from traditional utility generation of power. IPPs sell power almost exclusively at wholesale, while utilities principally sell power to retail customers. IPPs do not build rate-base power plants and generally do not charge rates determined in regulatory cost-of-service ratemaking proceedings. IPPs must finance the construction of a new generating facility based substantially on rates that the IPPs negotiate with their wholesale power purchasers, the electric utilities. Independent power projects are nonrecourse project-financed, which means that a project is only developed after an electric utility commits to the purchase of power from the IPP at agreed-upon rates and under terms and conditions that provide sufficient revenues to amortize the nonrecourse financing.

Independent power plants are not built on speculation or perceptions of wholesale market opportunities. Independent power

plants are built to meet the power needs of specific utility customers who commit to long-term, firm commitments for the supply of wholesale power. These long-term, firm commitments are the essential predicate for an IPP project.

IPP project development is an expensive and time-consuming process. In many states, utilities are required to conduct competitive bidding before beginning to negotiate a long-term power purchase commitment with an IPP project. In other states, utilities negotiate at length with prospective project developers. Utilities typically seek commitments of 15 years or more from an IPP project. Once an initial power purchase commitment is obtained, it may take two years or more before all other project contracts, including steam sale contracts, construction contracts, transmission arrangements, and fuel supply contracts, are concluded and regulatory approvals obtained, sufficient for a commercial lender to be willing to extend nonrecourse financing for construction of the project. Construction of a large power project may take in excess of two years. Thus, IPPs will have invested substantial resources and time in developing a project based on the initial long-term commitment from a utility power purchaser.

The prospect that a substantial and unforeseeable operating expense may be imposed on an IPP project after the developer enters into its firm power purchase commitment places independent power at a substantial financial and competitive disadvantage. Few, if any, existing power purchase contracts provide for the power purchaser to pay a national energy or Btu tax. Moreover, these contracts do not contain "reopener" provisions that would provide for a passthrough of the tax to the IPP's power purchaser. Thus, IPPs are faced with the prospect of absorbing the unforeseen energy tax. Such absorption by the IPP would undermine the basis of nonrecourse financing, threatening bankruptcy in some cases, and in all cases, causing a substantial economic hardship to the developer.

An energy tax imposed at the retail level would eliminate all of these anomalies. The next best option would be for the tax to be imposed after generation, on the distribution of the electric power. At a minimum, any IPP project that had obtained a long-term power purchase commitment from an electric utility, which commitment does not permit the direct passthrough of the proposed energy tax, prior to the date of enactment of the energy tax, should be eligible for grandfather relief in the form of a mandated imposition of the tax on such power purchaser. To deny IPPs such relief would threaten the viability of many existing and under-development projects and be contrary to the policies behind the energy tax. If IPPs operating or being constructed under firm commitments are required to absorb the fuel tax, a significant portion of the nation's electric capacity will be substantially weakened.

Congress has previously granted IPPs relief from unanticipated, federally mandated expenses. In the Clean Air Act Amendments of 1990, Congress imposed on all power plants the obligation to reduce sulfur dioxide emissions through a system requiring all plants to hold emission allowances for each ton of emissions. The sulfur dioxide emission system was intended to apply to all existing utility plants. However, Congress exempted all IPPs that had entered into power purchase commitments with power purchasers prior to enactment of the new environmental limitations and the emission allowance trading system. See Section 405(g)(6) of the Clean Air Act Amendments of 1990, 42 U.S.C. §§ 7651 et seq. The Environmental Protection Agency recently issued implementing regulations that confirm exemptions for IPPs that are not able to directly pass through to their power purchasers the new costs of environmental compliance. See 58 Fed. Reg. 15634 et seq. (March 23, 1993).

As was the case with the Clean Air Act Amendments of 1990, Congress and the Administration should provide transitional relief for IPPs that have developed projects or made firm commitments based on pre-energy tax energy costs.

. III.

The Administration has proposed grandfather relief from the energy tax for IPPs that entered into fixed-price contracts prior to date of enactment. However, to be equitable and effective, such grandfather relief must be implemented in a manner that fairly takes account of the varied long-term, firm pricing arrangements that IPPs have with their utility purchasers and fuel suppliers.

1. A Certificate System that Assures Collection of a Single Tax.

The Administration proposes a tax collection and credit mechanism for implementing the proposed IPP grandfather relief that would be unnecessarily complicated and burdensome. The EGA proposes a means to ensure that grandfather relief be implemented through a less cumbersome mechanism that would be fair to IPPs, utilities and fuel suppliers, and would not sacrifice revenues.

The Administration proposes a double-tax collection mechanism that would require both the grandfathered IPP and the utility power purchaser to pay the full energy tax, while the IPP would be eligible to file for a subsequent refund or credit. This double tax collection mechanism is burdensome and costly to the IPP and is not needed to ensure that the government collect amounts properly due.

The EGA believes that grandfathered IPPs should be exempt from collection of the tax upon providing a certificate to their power purchasers of the amount of tax properly due from them based upon the Btu content of the fuel consumed by the IPP in the generation of the power purchaser's electricity. In the event that the amount of tax properly allocable to a power purchaser is less than the amount of tax that would otherwise be due from the IPP, the IPP would be liable for a single payment of the difference. In the circumstances where the IPP has purchased natural gas upon which the Btu tax has already been paid, the IPP should be entitled to a refund. In such circumstances, the utility power purchaser would not also be liable for the tax. Thus, the Administration's proposed grandfather relief can be most efficiently implemented through a scheme involving only a single collection of the full amount of the energy tax, rather than by the cumbersome double tax collection and credit mechanism which the Administration proposes. The government would be assured full collection of tax due under the single-tax collection mechanism.

2. Scope of the Class of Grandfathered IPPs.

A. Definition of Fixed-price Contract

The Administration proposes to provide grandfather relief for "fixed-priced" contracts entered into by the IPP before the date of enactment. The term fixed-price contract obscures the variety of long-term, firm pricing commitments that are included in individual IPP-utility contracts. The rationale for grandfather relief is to avoid penalizing an IPP that is contractually unable to pass through the energy tax to the utility that purchases its power. The class of grandfather-eligible IPPs should be defined to encompass all IPPs with long-term, firm commitments that do not permit full passthrough of the energy tax.

IPP-utility power sales contracts vary considerably in their formulas and provisions which set prices. Relatively few, if any, existing IPP-utility contracts permit the direct passthrough of a federal energy tax. However, many IPP contracts contain price formulas that permit the price of purchased power to vary over time in relation to changes in fuel costs. These "fuel price escalator" provisions may base the utility's purchase price on some measure of the utility's avoided fuel costs or on some benchmark measure of regional or national fuel costs. While power purchase contracts may provide for the variability of the price of electricity based on some measure of fuel costs, it will be far from clear in many cases whether such measure of fuel costs will incorporate the Btu tax. In many cases, the contract provisions or the fuel price escalators will be based on a measure of fuel costs that does not incorporate the Btu tax. Even under power purchase contracts that provide indirectly for some passthrough of the energy tax based on a fuel index or avoided cost, such passthrough may be incomplete and significantly deferred in time.

The Administration's decision to move the fuel tax downstream to different points for different fuels inadvertently exacerbates the IPP's difficulty in passing through the fuel tax. Now, IPPs may be purchasing some fuel tax-paid and other fuel which has not yet been taxed. Utilities and IPPs will not necessarily be purchasing fuel on which tax is paid at the same time. Moreover, there will be greater uncertainty, and potential for litigation, over the application of fuel price indices and avoided cost measures where the tax is applied at different points relative to the IPP and its purchasing utility.

The movement of the fuel tax downstream also opens the door to a potential windfall gain for IPP fuel suppliers and windfall loss for IPPs. Many IPPs hedged their fuel supply contracts and electric sales contracts. Under a hedged arrangement, fuel supply and electricity prices would increase based on the same index. Paradoxically, the IPP with a perfect hedge will bear the full amount of the fuel tax if the presence of its escalator provisions denies it the benefit of grandfather relief. This windfall loss occurs because the IPP may be required to pass through the effects of the fuel tax in higher prices paid for fuel, even though the fuel supplier no longer bears any tax burden under a downstream tax.

This brief discussion of IPP fuel supply and power sales contracts underscores the difficulty in limiting grandfather relief to some defined class of "fixed-price" contracts. The only way that IPPs with firm long-term contracts can avoid bearing the fuel tax is if the grandfather relief mechanism permits the IPP to pass through the full incidence of the fuel tax.

The government's objectives are full and immediate tax collection, without administrative involvement of the IRS in determining eligibility for or computation of the grandfather relief. The IRS should not be burdened with making contract interpretations of fuel price escalator and avoided cost provisions. Grandfather eligibility should be a largely self-administered process that leaves interpretation of uncertain contract provisions to the parties. Moreover, an IPP's eligibility for grandfather relief need not be all-or-nothing and need not be a one-time-only determination. Flexibility can be provided at no cost to the government and without involving the IRS in contract interpretation or resolution of disputes between IPPs and utilities.

The basic principle that should underlie the definition of grandfather-eligible IPPs is that if an IPP collects from its power purchaser a purchase price of electricity that includes the applicable Btu tax, grandfather relief is not appropriate. If, however, an IPP does not collect a contractual price of electricity that includes the Btu tax, grandfather relief

is appropriate. This principle can be self-administered through a certificate mechanism that tracks the inclusion or exclusion of the incidence of the fuel tax from fuel supply and power purchase prices.

B. Contract Prior to the Effective Date of the Tax.

The Administration proposes to permit grandfather relief for contracts entered into prior to date of enactment. For purposes of this effective date, contracts should include any contracts entered into after date of enactment but which, prior to February 23, 1993, were the subject of the submission of a bid in a competitive solicitation, a regulatory order issued by a state public utility commission, or a signed letter of intent. Congress recently recognized such power purchase commitments as a basis for grandfather protection from federal legislation that imposed acid rain pollution costs on IPP generators. See Section 405(g)(6) of the Clean Air Act Amendments of 1990 and implementing EPA regulations issued at 58 Fed. Reg. 15634 et seq. (March 23, 1993). These power purchase commitments are entered into at the inception of IPP project development and limit the IPP's anticipated revenue stream from a project. In reliance on these commitments, IPPs commit substantial expenses in developing a project and obtaining necessary government approvals prior to commencement of construction. Formal execution of power sales contracts might occur substantially later in the development process and are based upon the preliminary purchase price commitments made by the IPP and utility in a competitive bid, regulatory order or letter of intent.

The grandfather relief should fairly be made available to all IPPs that had a power purchase commitment prior to date of announcement of the Administration's energy tax proposal, even if such commitment ripened into a power sales contract after the date of enactment. As under the Clean Air Act program, such commitments can be identified under a self-administered tax system.

3. Steam.

Under PURPA, qualifying cogeneration facilities ("QFs") must sequentially utilize thermal energy (steam) in the generation of electricity (by powering turbines) and in the delivery of residual steam to an industrial facility. The Federal Energy Regulatory Commission ("FERC") has in place extensive regulations governing this sequential process. See 18 CFR § 292.101 et. seq. The object of PURPA and its implementing regulations is to discourage the waste of residual thermal energy which remains after the generation of electricity.

QFs are required to meet performance standards that ensure that a portion of residual thermal energy remaining after electricity generation be delivered to an industrial facility rather than be wasted. The sequential utilization of residual steam by an industrial user does not detract from the precedent use by the QF of all of the consumed fuel to generate electricity. Residual steam that would satisfy the PURPA performance requirements is simply a by-product of electricity generation.

QFs structure their firm contracts with both the utility purchasers and the industrial steam users to permit recovery of anticipated fuel costs. Many existing QF contracts would not permit the direct passthrough of the Btu tax to the utility purchasers or industrial steam users. Consequently, where QFs are unable to recover the Btu tax under firm contracts that do not passthrough the tax, grandfather relief effective for the full amount of a QF's tax burden is appropriate. The rationale for

grandfather relief is as strong for fuel associated with industrial steam use as for fuel associated with electricity generation. Unless the tax law requires the pass through of the Btu tax associated with steam, some industrial users will obtain thermal energy without bearing a tax burden, whereas industrial users that obtain steam from other fossil-fuel fired sources will bear the full tax burden. Such a result would be inconsistent with the energy conservation rationale of both the proposed energy tax and PURPA.

The EGA believes that effective grandfather relief for QFs should be provided through the following allocation of fuel tax. The utility buying electricity from a grandfathered QF under a firm contract would bear the Btu tax to the extent that fuel consumed by the QF was used in the generation of electricity and any residual steam provided to an industrial user met the PURPA requirements for sequential utilization. To the extent that a QF provides steam to an industrial facility under a firm contract in periods when electricity is not generated or in a non-sequential process that would not meet PURPA requirements, the Btu tax would be borne by the industrial user. In each case, the QF would be entitled to a credit or refund of the Btu tax it paid or bore from the purchase of tax-paid fuel.

4. Particular contractual situations.

In some states, power sale agreements between IPPs and utilities were required to include provisions forcing the IPPs to absorb all new taxes imposed on the sale of the electricity by an IPP, even if the collection point of such taxes is on the utility. These contractual provisions exist in certain Southern California and Virginia IPP projects. By imposing the Btu tax on utilities that purchase power from IPPs, these contractual provisions may be brought into full force and effect. The hardship to the IPPs from application of such contracts can be avoided if the normalization rules which otherwise encourage passthrough by a utility encompass all energy taxes paid by the utility, including the special tax paid by the utility on power purchased from grandfathered IPPs. Effective normalization rules would not penalize utilities that enjoyed contractual protection from taxes imposed on electricity sales. The rules would ensure that all such taxes be borne by retail electricity consumers and not by either the IPP or the utility.

* * *

In conclusion, the EGA strongly supports imposition of the proposed fuel tax on the retail sale of electricity. A retail tax is the fairest and most efficient tax for encouraging energy conservation. If Congress does not enact a retail tax, the Administration's proposal for grandfather relief for IPPs should be revised to provide a self-administered, single tax mechanism that ensures that IPPs with long-term, firm contracts be entitled to pass through the full incidence of the Btu tax in the utilities' purchase price for electricity.

STATEMENT OF HORSEHEAD INDUSTRIES, INC.

Mr. Chairman and members of the Committee on Finance: As President of Horsehead Industries Incorporated (HII), I appreciate the opportunity to present our views on the Administration's proposed Btu tax, and to recommend modifications that will better fulfill the Administration's policy objectives. The Zinc Corporation of America (ZCA), a subsidiary of Horsehead Industries, is the United States' largest manufacturer of zinc, producing more than 50 percent of the annual U.S. production. Together with its sister corporation, Horsehead Resource Development Company, Inc. (HRD), ZCA and HRD are North America's largest recycling team, recovering zinc from secondary, scrap and waste materials which would otherwise go to landfills.

Mr. Chairman, as an American and a businessman, I fully support the laudable policy objectives of the Administration. Few can argue with conserving energy, decreasing reliance on foreign oil, improving the environment and reducing the annual deficit. The first objective enhances the quality of our lives; the second and third, our independence as a nation; and the last objective is critical to our survival as an economic superpower. However, the energy tax will fall woefully short of advancing these objectives in its application to zinc production. The tax will instead force domestic producers to absorb significant cost increases when their products are sold on the basis of an internationally determined price. Additionally, domestic producers compete against foreign producers—many highly subsidized—not subject to the tax or to stringent environmental standards. In sum, the tax will favor: (1) imported zinc over domestically-produced zinc; (2) mined ore produced outside the U.S. at the expense of domestic recycling; and, (3) less environmentally sound forms of zinc production.

In order to truly advance the sound policy objectives of the Btu tax, HII maintains domestic zinc producers and recyclers must be provided a level playing field. We support the non-fuel use exemption for coal and petroleum, including the related application of coke to produce steel, zinc and aluminum and further recommend:

- Defining "feedstock" to recognize the essential use of energy in the production of internationally priced commodities. Electricity should be recognized as a "feedstock" in the production of zinc.
- Excluding "Industrial power plants" from the tax as are independent power producers.
- The only other alternative would be imposing a 2% border tax on zinc imports so that domestic producers can compete fairly with foreign producers for the U.S. market. This border tax can be reduced if the first two recommendations are implemented.

As the Committee recognizes, apart from raising revenue, the Btu tax is meant to be passed along to the ultimate consumer, who presumably has the ability to reduce energy consumption. However, zinc is traded daily on the London Metals Exchange (LME), where price is established irrespective of the internalized cost of production. As a result, domestic zinc producers must absorb any cost increases within an internationally determined price and must remain forever vigilant on the costs of energy to meet these prices. Minimizing energy consumption is especially important since that represents one of the highest cost components of zinc production.

Zinc producers cannot pass the increased costs of the energy tax along to consumers any more than we can pass along inefficient consumption of energy. Yet we must sell our commodity in a competitive domestic market increasingly dominated by subsidized foreign imports which will neither be subjected to the tax nor produced under as stringent environmental requirements. The objectives of the Btu tax cannot hope to be fulfilled by substituting domestic zinc production with imported zinc requiring greater energy to produce and to transport vast distances.

Thus, as currently constituted, the Btu tax on zinc is unworkable and must be modified. We stand ready to assist the Committee in exploring alternatives that will achieve the fundamental objectives of the Administration, without these dysfunctional effects.

I. THE ZINC INDUSTRY

ZCA and HRD's operations are located in New York, Pennsylvania, Texas, Oklahoma, Illinois and Tennessee and are combined through an interconnected, multi-facility industrial process.

The processing of zinc-bearing materials requires energy in order to separate zinc from other metals in the host material. Specifically, ZCA produces electricity for its own internal use at its independent industrial power plant in Monaca, Pennsylvania, having made substantial investments to achieve compliance with stringent en-

environmental air quality regulations. Electrical energy is the primary source of power used at the Oklahoma zinc plant to convert the concentrated zinc bearing material to refined zinc metal.

Zinc is refined into various forms and is used in many different processes and products:

Zinc metal is used in galvanized steel, brass, die cast components and rolled zinc for minting the U.S. penny.

Zinc oxide is a mineral supplement in human and animal diets and is used for applications in the rubber, chemical, ceramic, glass, paper, pharmaceutical, plastics, and electro-galvanizing industries.

Zinc dust is used in chemicals and corrosion-resistant coatings.

Zinc alloys are employed in die casting products and parts, from automobile carburetors and fuel pumps to household appliances and tools.

Zinc powder is used in products ranging from long-life alkaline cell batteries to brake linings.

In the U.S. alone more than 1.1 million short tons of zinc were consumed in 1992 with over 20 percent of that total created from recycled material. However, U.S. producers supply less than 40 percent of the zinc needed in the U.S. Sixty percent of annual U.S. consumption is imported—most of which is produced in Canada and Mexico. Twenty five years ago the U.S. was self sufficient in zinc production with capacity of approximately 1 million tons per year. Today, the remnants of that U.S. industry compete with global giants, many of whom operate with the benefit of extensive government subsidies.

Zinc is an internationally-traded commodity for which the price is set daily on the London Metals Exchange (LME). Therefore, the price that ZCA and HRD receive for its products is set on the LME and all elements of production cost—raw materials, labor, energy and regulatory compliance—must be covered by the commodity's price. Consequently, U.S. producers compete with all other world producers (for example, Canada, Mexico, Australia, Japan, Europe) in a highly competitive world market.

II. THE OBJECTIVES OF THE PROPOSED ENERGY TAX WILL NOT BE ADVANCED BY A TAX ON DOMESTIC ZINC PRODUCTION

The objectives of the Administration in imposing the Btu tax are to:

- Reduce the deficit and raise significant revenues in a neutral way;
- Conserve energy by encouraging consumers to find the most efficient use of energy and reduce consumption, i.e. to facilitate pass-through;
- Reduce environmental damages by providing an incentive to use clean burning fuels;
- Reduce dependence on foreign sources of oil.

The tax is intended to fulfill these policy objectives without ancillary economic costs, such as costs to our industries in foreign trade. However, in application to U.S. zinc production, the tax fulfills none of the Administration's policy objectives and is often counterproductive.

A. The Tax Will Not Advance Revenue and Competitiveness Goals

The tax cannot be passed through to the consumer. In order to meet Administration objectives for the energy tax, according to the Department of Treasury, the tax should "be allowed to be passed on to the end user." The tax is optimally designed to facilitate pass through in order to place the ultimate consumer of the energy in a position to either reduce consumption levels or use alternative and more efficient forms. However, if this objective is to be fulfilled, those that bear the incidence of the Btu tax must have the ability to reduce consumption. If not, the positive behavioral changes sought to be induced will not occur.

In the case of zinc (and other nonferrous metals), price is determined daily on the London Metal Exchange (LME). Therefore, domestic and foreign zinc producers are inherently bound by the established commodity price which means they must seek to reduce their costs of labor, materials and energy to compete in the global market. Energy is essential in making zinc, and represents a substantial portion of production cost. As a result, a price increase unilaterally imposed by the U.S., through a Btu tax, for example, must be absorbed within the international price by U.S. producers only.

The domestic industry cannot absorb the cost increase. The environment in which domestic zinc industries produce and compete will not permit them to absorb these increases in production costs caused by the Btu tax. Today's zinc prices are equivalent to recession or depression levels—prices at which U.S. producers are struggling to survive. The low price has been caused by global recession, combined with exces-

sive zinc production from the Commonwealth of Independent States, and the recently implemented zinc sale from the National Defense Stockpile. Consequently, zinc producers are highly vulnerable to any cost increase; but, especially from energy, which represents a high percentage of total production cost.

Continued increase in the demand for zinc in the U.S. will be met by foreign producers, resulting in a lower U.S. tax base. As the tax on zinc production rises, an increasing domestic and international demand for zinc will be met by subsidized foreign production. This, in turn, will diminish the U.S. tax base on which the tax is predicated. The industry's inherent inability to absorb energy cost increases could result in a shutdown of portions of the domestic industry, triggering higher levels of foreign zinc production and importation in to the U.S.

B. The Tax Will Not Advance Environmental Goals

The energy tax, as proposed, tends to discourage recycling and resource recovery. Application of the tax to zinc production will not advance the environmental objectives of the tax, and may even be counterproductive to fulfilling those objectives. In fact, the policy disfavors recycling.

Quantities of zinc presently supplied through domestic production, 20 percent of which is recycled material, could be replaced by foreign-sourced material produced from mined ore. Therefore, the tax as presently proposed favors foreign, mined-ore production over recycling. Thus, vast quantities of what are listed as hazardous wastes, which presently are a significant source of domestically produced zinc, will be buried in landfills, creating a perpetual environmental threat. In Horsehead's case, we recycle huge volumes of the Nation's hazardous wastes produced by the steel industry for conversion into zinc metal at ZCA's Monaca, Pennsylvania and Bartlesville, Oklahoma plants. Feedstock for this production originates at steel mills where zinc-bearing emission dust, listed as hazardous waste, is generated. These dusts begin the recycling chain at our HRD Pennsylvania, Tennessee, and Illinois facilities. This opportunity to recycle and recover values from high-volume, listed hazardous waste is placed in Jeopardy with a burdensome energy tax which disproportionately affects a domestic producer.

The tax will not solve or advance environmental concerns by supplanting domestic production, operating under stringent environmental standards, with foreign production under less stringent standards. Undoubtedly, the tax will increase reliance on foreign-produced zinc, much of it produced south of our borders, where stringent environmental standards are not present. Global environmentalists should prefer this segment of industrial production remain in the U.S. with its system of standards and controls. The countries to which this production will be exported do not require the stringent environmental controls that are routinely required in the United States.

Most countries do not enforce their environmental laws to the same standards of environmental protection as is practiced in the U.S. Ironically, because demanding higher levels of zinc production from other countries would hinder the goals of the Kio summit. The result would be a net increase in pollution globally, if zinc production were to be curtailed in the U.S. and shifted to foreign countries. Additionally, increased mining of zinc ore would be required to compensate for reduced U.S. zinc production from recycled materials. Mining results in the generation of huge tailings piles, presenting solid waste management problems elsewhere.

C. The Tax Will Not Conserve Energy

The tax will not promote energy conservation in zinc production because zinc is an internationally-priced commodity—U.S. producers strive to be low cost producers in order to compete in the market. Thus, U.S. zinc producers already seek to minimize energy consumption and therefore costs of production. The energy tax is expected to add approximately one cent per pound to the production costs of domestically produced zinc, representing 2 percent of the current price. As presently proposed, the tax will reduce U.S. producers' competitiveness. Ironically, the resulting imports will actually increase world energy consumption through significant energy used for overseas transportation.

D. The Tax Will Have Other Negative Effects

The tax will reduce or eliminate domestic co-production of other essential minerals. Zinc is found with other essential minerals, including copper, bismuth, silver and cadmium. To the extent domestic production of zinc decreases, domestic production of these minerals will also decrease.

CONCLUSION

HII applauds the Administration's objectives as proposed in the Btu tax. Unfortunately, those objectives are not advanced by the tax as applied to zinc producers. Instead, the tax will place domestic producers at a competitive disadvantage to foreign producers on our own soil. From a global standpoint, the tax will not advance environmental goals by transferring domestic production to countries which have less stringent environmental controls.

On behalf of HII and its more than three thousand employees, I strongly urge the Congress to fashion appropriate exemptions for the non-ferrous metal industries reflecting the inherent difficulties of selling commodities, for which prices are fixed on International exchanges.

STATEMENT OF THE INDUSTRIAL GASES MANUFACTURERS COUNCIL

Mr. Chairman and members of the Committee: This Committee faces an important task as it begins drafting legislation to implement the President's economic plan—including provisions to reduce the budget deficit and to encourage long-term economic growth. We agree that deficit reduction is an important problem that must be solved.

The Industrial Gases Manufacturers Council represents an almost invisible industry that nonetheless is very important to the U.S. manufacturing base and our national security. Our member companies extract gases (oxygen, nitrogen, argon, etc.) from the air so they can be used by other manufacturers to improve the energy efficiency and environmental impact of their operations and by other customers for a wide range of important environmentally responsible purposes.

In its current form, the tax would place an unreasonable burden on our companies. Electricity costs account for up to 70% of the cost of producing atmospheric industrial gases; consequently, the proposed Btu tax could increase our production costs by about 70 times the burden that the Administration has cited for the average U.S. manufacturer. If we pass on those increased costs to our manufacturing customers, their products will be less competitive. And many of our member companies simply cannot pass the level of taxes proposed on to their customers.

THE ATMOSPHERIC GAS INDUSTRY

Atmospheric industrial gases—oxygen, nitrogen, and argon—are essential to the production of a wide range of critical industrial products from steel and semiconductors to chemicals and petroleum. They are widely used in aerospace, metalworking, food processing, the health care field as well as for hazardous waste remediation and for waste water treatment.¹

The production of atmospheric industrial gases typically involves the use of substantial amounts of electricity. Electricity is a basic element in the "cryogenic separation process," which is essentially an electrothermal separation process. Electricity is used to produce the necessary refrigeration that develops the extremely low temperatures for air to be liquefied. The liquefied air is then distilled into its component gases (oxygen, nitrogen, argon etc.) in the temperature region of minus 320° F.

The following is a summary of the significant policy concerns we have with the Administration's current Btu tax proposal.

THE PROPOSED BTU TAX BURDEN ON ATMOSPHERIC INDUSTRIAL GASES IS EXTREME—IT IS ABOUT 70 TIMES THE BURDEN ESTIMATED BY THE U.S. TREASURY FOR THE AVERAGE MANUFACTURER.

More than 70% of the manufacturing cost of atmospheric gases is energy cost—as compared to the 2.6% cited for the average manufacturer.

The Btu tax would increase industrial gas producers' electricity costs 8–10 percent, as compared to the 1.1 percent increase cited for the average consumer. Electricity costs for this industry are necessarily among the lowest in the manufacturing sector. Utilities provide favorable rates because of this industry's electricity load characteristics and the lower quality of service demanded. Like some other large electricity users, the atmospheric industrial gases production process has a steady state demand, but unlike almost all other manufacturers, the industrial gas industry has invested in and installed the technology to shut down during peak utility

¹The attached "pie chart" shows the various customers' share of atmospheric industrial gas uses.

demands, thus allowing power suppliers to avoid using their least efficient generation equipment.

THE USE OF THE ATMOSPHERIC INDUSTRIAL GASES PROVIDES SUBSTANTIAL ENVIRONMENTAL BENEFITS AND SHOULD BE ENCOURAGED.

Much of the demand for industrial gases is specifically for environmental purposes. They are used for hazardous waste remediation at superfund sites, in manufacturing processes to reduce emissions (such as dioxins, sulfides, CFC's, NOx, solvent vapors) as well as to treat wastewater and oxygen depleted waterways such as Russell Dam.²

There are alternative processes that do not require the use of energy efficient industrial gases; thus the extreme tax burden on these gases creates artificial competitive barriers that run counter to the overall Administration goal of providing environmental benefits through the energy tax.

THE USE OF ATMOSPHERIC INDUSTRIAL GASES REDUCES THE U.S. RELIANCE ON IMPORTED PETROLEUM.

An exclusion for atmospheric industrial gases from the Btu tax would further the Administration's objectives of increasing energy conservation and decreasing U.S. dependance on foreign oil since a major use of industrial gases is to enhance fuel efficiency and the utilities supplying the industrial gases rarely use petroleum as a fuel source.

Many industrial applications of atmospheric industrial gases result in substantial reductions in fossil fuel consumption. Oxygen-enriched combustion can reduce by two-thirds the heat lost to the atmosphere in a number of energy-intensive applications. For example, oxygen can be used in steel furnaces to reduce coke input by 20 percent, or to reduce natural gas consumption by up to 70 percent in the manufacturing of various primary metals. In the food industry, use of nitrogen can reduce power consumption for food freezing by 20 percent.³

THE BTU TAX WOULD SIGNIFICANTLY DISRUPT INDUSTRIAL GASES PRICING STRUCTURE AND COMPETITION.

Industrial gas production is a highly competitive, 85 year old industry in which gas producing companies primarily compete through prices, and only the most energy efficient production facilities will be successful in attracting major new customers.

Many companies will be unable or unwilling to accept the amount of price increases that would be necessary for this industry to recoup the proposed tax.

The ability to pass on the cost of the tax is limited by competition and long-term contracts. Industrial gases are typically supplied through long-term contracts, particularly to large customers such as steel mills and petrochemical producers, whose requirements are provided via pipeline. These contracts, which are often 10-15 years in duration, can limit the ability of the industrial gas producer to pass through all, or portions of, an energy tax.

This disruption does not seem justified in light of the federal revenues that might be derived from the industrial gases industry. Although the production of industrial gases is highly energy intensive, the industrial gases industry estimates current total usage of energy to be approximately 200 trillion Btus. We estimate that the Administration's proposed modified Btu tax would produce at most \$50-\$55 million in gross revenue when fully phased in (a "static" estimate that does not factor in any tax induced decline in production), and only \$32-\$35 million in net revenue (assuming a 36 percent corporate income tax rate and no pass through to customers).

The industry's total installed capital base is approximately \$6.5 billion. A modern, efficient air separation plant currently requires a capital investment of approximately \$15 million.

The Btu tax would significantly undermine the industry's ability to invest in new and efficient plant and equipment—investment which over the past 20 years, has improved energy efficiency within our own production facilities by approximately 28 percent. We believe that the current Btu tax proposal would reduce the number of new plants constructed in the U.S. by an average of 4 per year.

² The attached chart provides a listing of many of the environmental uses and ways in which atmospheric industrial gases are used to decrease the reliance on imported petroleum.

³ Attached chart provides a more complete listing of the energy saving applications.

AN EXEMPTION FROM THE BTU TAX PROPOSAL WOULD BE CONSISTENT WITH ENERGY TAX PROPOSALS IN OTHER COUNTRIES. THE EC PROPOSAL EXCLUDES MUCH OF INDUSTRY FROM ITS ENERGY TAX BASE.

The proposed energy tax in the EC stipulates that it will not be implemented until other OECD countries impose a similar burden on their industries—a "you go first" strategy.

More importantly, the specifics of the current EC proposal indicate that the EC intends to provide significant industrial exemptions needed to preserve its job base. Even the most severe of those industrial exemption options for EC member countries would be significantly less burdensome on our industry than the Administration's Btu tax. The EC energy tax proposal would exempt 90% of the energy used by its industrial gases industry and other industries that have energy costs which exceed 30% of the total costs associated with the value added by the industrial process. For less energy intensive processes, the exclusion would be phased down according to the energy use.

The EC proposal also includes a clause designed to permit EC member states to reduce the amount of tax for companies' energy saving investments. It is our belief that the EC is referring to the kinds of energy saving investments that the industrial gases industry and our customers, who modify their production process to use industrial gases, are making in the U.S.

AN EXCLUSION WOULD HELP PRESERVE THE COMPETITIVE POSITION OF U.S. PRODUCTS.

To the extent that producers are able to pass on some portion of the Btu tax to their customers—chemical, petrochemical, steel and automobile producers, semiconductor manufacturers, hospitals, the food industry—the tax will be inflationary and will harm U.S. competitiveness. These price increases will hit many sectors of the economy in which the Administration is presently trying to contain costs. Moreover, while the gases themselves are rarely exported, many of the industry's customers are among the country's leading exporters whose competitiveness in export markets will be weakened.

AN EXCLUSION COULD ALSO BE DEvised UNDER A MORE GENERAL NON-FUEL USE.

We believe that a clarification that the Btu tax will not be imposed on the energy used to produce atmospheric industrial gases would be consistent with President Clinton's expressed desire and intent to exempt non-fuel uses of energy from the tax. The energy consumed in the air separation process ultimately allows our customers to save energy. The industrial gases industry, a segment of the Chemical industry, uses electricity as a basic driving force in an electrothermal process; atmospheric industrial gases are in fact classified as specialty chemicals in SIC code 2813.

RECOMMENDATION

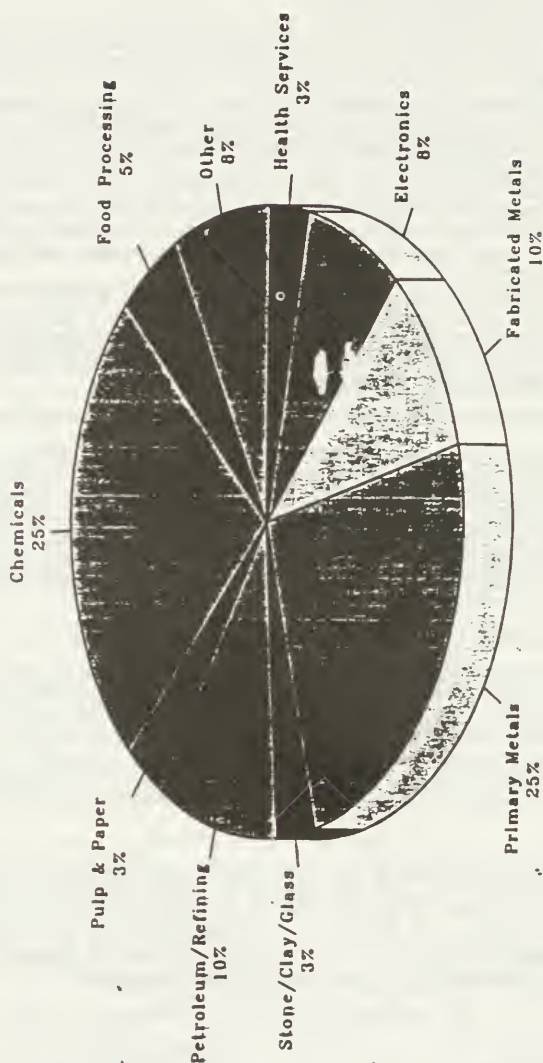
For the foregoing reasons, the Industrial Gases Manufacturers Council requests a clarification that the energy used in the production of atmospheric industrial gases is exempt from any broad-based energy tax. Such an exemption, which should be total or certainly no less than that established in the EC proposal, would recognize the unique intensity of energy consumption by this industry, which is vital to a competitive manufacturing base and our national security.

THE INDUSTRIAL GASES MANUFACTURERS COUNCIL

AGA Gas, Inc.
MG Industries, Inc.
Airco Gases
National Welders
Air Liquide America Corp.

Norris Cylinder
Air Products and Chemicals
Praxair, Inc.
Liquid Carbonic Corporation
Tri-Gas, Inc.

ATMOSPHERIC GAS MARKETS



Environmental/Energy Savings Applications for Industrial Gases

Atmospheric industrial gases such as nitrogen, oxygen and argon are used in manufacturing processes to achieve a broad range of pollution reduction and energy saving benefits that are vital to moving the nation towards heightened levels of energy efficiency. The industrial gases industry is a key participant in the delivery of energy saving and pollution reduction technologies to both U.S. and foreign manufacturers.

A substantial portion of the uses of atmospheric industrial gases reduces pollution and energy consumption. The atmospheric industrial gases production process is energy friendly in that it permits the electric utilities to curtail power in times of peak power demand, thus eliminating the need for additional generating capacity. The following lists some of the many uses of atmospheric industrial gases and their related benefits.

| Industry | Application | Product | Description/Benefits |
|-----------------------------|---------------------------------------|---------|---|
| Hazardous Waste Remediation | Hydrocarbon contaminated soil cleanup | oxygen | This system provides oxygen dissolution technology for the biological cleanup of hazardous waste. |
| | Cleaner incineration | oxygen | Oxygen and burner technology enhances the combustion of hazardous waste. Often these are large remediation projects using portable incinerators. Destruction and removal efficiencies are improved; NOx and particulate emissions are reduced; reduces energy input by 30%. |
| Clean Water | Still water oxidation | oxygen | This technology provides oxygenation of deep water dams (such as Russell Dam) and other depleted waterways. |
| | Waste water treatment | oxygen | New oxygenator technology increases waste water treatment rates using less energy; used by tannery industry and others. |
| Hospital/Healthcare | Sterilizing Gas Recovery Technology | oxygen | This process deals with all components of sterilizing gas exhaust including hazardous and toxic materials produced during the sterilization process; efficiently condenses CFC's for recycling. |
| | Respiratory/inhalation therapy | oxygen | Home healthcare and hospital use. |

| Industry | Application | Product | Description/Benefits |
|--------------------|--------------------------------|-------------------------------|---|
| Municipal | Waste water | oxygen | Essential to many waste water treatment processes to meet government standards. |
| Food | Food freezing | nitrogen | Cryo-mechanical integration technology channels cold gas to "boost" mechanical freezers, reducing power consumption by up to 20%. |
| Pulp and Paper | Reduced lime kiln | oxygen | Improves efficiency of lime kiln in meeting TRS (total reduced sulfur) emission targets. Reduces fuel consumption from 6 MM BTU/ton to 4 MM BTU/ton. |
| | Bleaching | oxygen | Oxygen replaces chlorine in a pulp bleaching process, thus reducing dioxins and furans in waste water. |
| | Waste water | oxygen | Enables effluent to meet environmental guidelines for dissolved oxygen. |
| | Black Liquor Ox. (BLO) | oxygen | BLO process is used to reduce sulfide concentrations. It also reduces steam consumption by 25 % for black liquor oxidation. |
| Electronics | Cleaner production | nitrogen | Production of precision electronic components in nitrogen atmosphere-mylar flux baking process eliminates the generation of harmful air pollutants during the formerly used final cleaning process. This technology eliminates the release of air pollutants such as chlorofluorocarbons and enhances efficiency of printed circuit boards. |
| Rubber and Plastic | Cryogenic grinding & recycling | nitrogen | Cryogenic properties of liquid nitrogen embrittle polymer materials to enable grinding, recycling and reuse. Scrap generation (landfill requirements) is reduced by up to 90%. |
| Welding | Light metal bonding | nitrogen/ oxygen/ argon | Utilization of a precise, blended gas mixture containing argon, oxygen, and nitrogen by automakers to weld together lighter, stronger metals helps to increase automobile fuel economy; eliminates air polluting residues from the welding process. |

| Industry | Application | Product | Description/Benefits |
|----------------------|------------------------------------|-----------------|--|
| Paints and Solvents | Vapor recovery systems | nitrogen | Vapor recovery systems for manufacturers and processors in these industries remove vapor contaminants from air safely, efficiently, and economically. Waste solvents are processed thru ultra-cold nitrogen, condensed and then separated and collected, with any remaining nitrogen and air returned to the atmosphere. |
| | Coal gasification | oxygen | Oxygen is used to gasify coal or heavy residual oil which is then treated to remove acid and reduce carbon dioxide emissions. |
| | Sulfur recovery | oxygen | Oxygen enrichment increases the capacity of a refinery's SRU (sulfur recovery unit) by up to 10 - 20%. |
| Chemical & Petroleum | Thermal oxidation/incineration | oxygen | Oxygen enrichment reduces natural gas requirements by 25%. |
| | Solvent recovery | nitrogen | Liquid nitrogen used as a refrigerant to condense and recover organic materials, reducing emissions by up to 99%. |
| | Sparging | nitrogen | Nitrogen used to strip contaminants from chemical processes. Also, proper system can reduce cycle time and reduce specific energy input by 10%. |
| Primary Metals | Aluminum recycling | oxygen | Oxygen and related burner technology enable efficient melting of used beverage containers and other aluminum materials. Increases capacity by 50% while reducing specific fuel consumption by up to 25%. |
| | Steel furnaces (Cupola enrichment) | oxygen/nitrogen | Injection of oxygen into pulverized coal used in steel furnaces replaces coke input by up to 20%. Nitrogen is used to transport the coal during the process. |
| | Ladle preheating | oxygen | Oxy-fuel burners improve combustion efficiency and reduce natural gas consumption by up to 70% in this and other primary metal applications. |

| Industry | Application | Product | Description/Benefits |
|----------------------------|--------------------|---------|--|
| Primary Metals (cont'd) | Copper smelting | oxygen | Autogenous smelting significantly decreases the use of fossil fuels by burning, as a fuel, iron ore and sulfur that is mined with the copper. |
| | Specialty steels | argon | Creates clean atmosphere for creation of specialty steels; increases productivity and quality. |
| Glass | Oxygen burners | oxygen | Oxygen-based burners enhance combustion in glass furnaces which reduces nitrous oxide emissions, increases productivity and lowers energy use. |
| Ceramics | Furnace technology | oxygen | Increases the yield while reducing emissions and the fuel gas used for firing. |

STATEMENT OF THE
INTERSTATE NATURAL GAS ASSOCIATION OF AMERICA

Mr. Chairman and Members of the Committee I appreciate having the opportunity to submit testimony for the record of the Senate Finance Committee on the President's deficit reduction proposals. My name is John Riordan and I am the President and Chief Executive Officer of MidCon Corp. headquartered in Lombard, Illinois. I am also the Chairman of the Interstate Natural Gas Association of America (INGAA) on whose behalf I submit this testimony. INGAA represents the U.S. interstate and Canadian interprovincial natural gas pipelines.

I would like to address today the issue of the Btu tax, specifically the collection point for natural gas, discuss the financial impact on pipelines of changes in the gas industry and raise other technical concerns we have with some of the provisions raised in President Clinton's proposed package.

The Natural Gas Btu Tax Should be Imposed on the Ultimate Consumer and Collected by the Seller of the Gas

When the Administration released its proposal, it recommended that the collection point be placed at the front or upstream end of the natural gas pipeline. The intent of the energy tax is to generate revenues from the users of the energy, with certain feedstock exemptions. This means the tax should be borne by the end-users or consumers of the energy. *Thus, a tax on natural gas should be imposed on the end-user and collected by the seller of the gas.* This is a position supported by the Natural Gas Council, a group comprised of the American Gas Association, the Interstate Natural Gas Association of America, the Independent Petroleum Association of America and the Natural Gas Supply Association.

The Collection Point

INGAA strongly believe the tax must be imposed at the ultimate end user level if the financial viability of local distribution companies (LDCs) is to be maintained.

Placing the tax on the ultimate consumer would cost the least, avoid an administrative nightmare and achieve the Administration's goals of energy efficiency and greater use of natural gas.

- The end user point of collection would be much easier to administer, since most gas utilities have computerized billing systems and are already set up to collect state taxes. Other sellers to end users also have sophisticated billing systems that could easily handle the Btu tax.
- Under FERC's massive restructuring order, Order 636, interstate pipelines no longer will buy and sell gas, but will simply transport it. They won't even know the price of the final use of the gas they transport. Since they won't know the ultimate use of the gas, pipelines would not be able to exempt non-fuel uses of natural gas (feedstocks), as the Administration has proposed. Gas often changes title many times before it is finally consumer, and trying to track all this in order to rebate non-fuel users would be a bureaucratic nightmare. It is also likely that a system this complex would lead to undercollections of the tax.
- A large amount of gas goes into storage facilities operated by either pipelines or LDCs. This gas might not be consumed for months or even a year. Forcing pipelines or LDCs to collect the tax would mean very lengthy delays in tax rebated to those that use the gas without burning it.
- Another new cost to consumers, if the collection point is not moved to the consumer, is the compounding of state and local sales and gross receipt taxes piggybacked on top of the Btu tax. In this case, consumers would be paying a tax on a tax.

Liability

The Administration proposal required that LDCs are liable for natural gas sold to their customers and gas transported behind their systems. INGAA believes that imposing liability on any segment of the natural gas industry is inappropriate and can jeopardize the financial viability of that segment. The intent of the Administration is to encourage conservation and efficiency which requires the liability for the tax to be on the end user. By requiring LDCs to be liable, LDCs have the potential to face significant financial costs. This can also provide an out to those who should be responsible for the tax not to pay it.

If primary or secondary liability is imposed on producers or natural gas marketers, given the competitive pressures of the natural gas market today, they would be required to absorb at least a portion of the Btu tax. Interstate pipelines would also be exposed to significant financial costs. However, because of the restructuring of the natural gas industry, they will not necessarily even know the end user or the use to which the gas will be put.

Pipeline Collection

The Clinton Administration has proposed imposing the tax upon Btu's measured at the outlet of the pipeline. This would mean the interstate pipeline would be the collector of the tax from the end-user or local distribution company (LDC). While this is *not* the mechanism supported by the Natural Gas Council, we had asked the Administration, if this was the ultimate approved mechanism, clarification should be added so that the intent of the Btu tax remained intact.

- Interstate pipelines should be required to remit to Treasury only what they collect from end-users or LDCs.
- LDCs must be guaranteed regulatory approval to recover the tax (this will require a federal pre-emptive clause ordering public utility commissions to allow LDCs to pass on the tax.)
- To avoid any double taxation (tax on tax), legislative language must be included stating that any Btu tax collected would not be subject to any other form of federal, state or local taxation.

Collecting Tax at the Pipeline Point-of-Entry Would be Unmanageable

The Administration had originally proposed collecting the tax at the pipeline point of entry. While this is no longer under discussion, INGAA believes that convincing arguments have been made and continue to be made for why the collection point should not be at the wellhead, the front or upstream end of the pipeline, the back or the downstream of the pipeline or the city gate. The following comments focus on the Btu tax as described in the Administration's original proposal which named the entry to the pipeline as the gas collection point. Taxing natural gas at the pipeline point-of-entry would require a massive tracking system that would be both unmanageable and could be inaccurate. In 1992, under "open access" regulations, 84% of the gas going through pipeline systems was owned by others and merely transported by the pipelines. Only 16% of the gas was sales gas, i.e., owned by the pipeline. As a result of recent federally mandated restructuring of the natural gas industry, interstate pipelines will no longer buy and sell virtually any of the gas that goes through their pipelines. They will simply serve as transporters of gas owned by others. Title to the natural gas commodity will not be conveyed at any time to the pipeline. Pipelines also will have no knowledge of the actual end-use consumer nor the non-fuel use status for exemptions of entities ultimately consuming the gas.

Collecting the tax at the entry to the pipeline, as initially proposed by the Administration, is not manageable because of the complexity and confusion resulting from the restructuring. While gas transmission may seem simple,

It is a complex network of transactions which, after restructuring, will be even more complex. Before the restructuring of the natural gas industry, a natural gas purchase typically consisted of a handful of individual transactions between the:

- producer and shipper (person who arranges the deal if the ultimate consumer does not do the arranging himself);
- shipper and the ultimate consumer; and
- shipper and the pipeline.

After the restructuring, a natural gas purchase will typically consist of many more individual transactions *in addition to* the ones listed above; that is, between the:

- shipper and storage owner (because purchase of storage capacity will be a separate service);
- shipper and other shippers (because gas will be pooled at market centers along the pipeline);
- pipeline and an upstream or downstream pipeline (because the restructuring releases market forces which are demanding this type of service);
- shipper and another customer (again, because of pooling at market centers);
- customer and other customers (because pipelines must allow customers to release their rights to the pipeline capacity to another party); and
- customer/shipper with other customers and shippers (because of the right of customers and shippers to substitute different receipt and delivery points along the pipeline).

Other combinations are likely and could happen over and over again. For instance, many expect the title to the gas to change hands repeatedly within a market center. As a result, the number of transactions for a single delivery could easily be dozens. It is difficult to develop a rationale for applying the tax before these many title changes are made.

Another problem is that an interstate pipeline transports natural gas to an exit point. It then bills the shipper for the transportation service later, i.e., billing occurs after-the-fact. The pipeline collects revenue only from the party paying the transportation rates. That party often is not the party that will eventually own or use the gas.

Interstate pipelines are also facing more competition which creates more pressure for pipelines to discount their transactions. It is not possible to specify in a pipeline's rate what is being discounted and what is not. Consequently, unresolvable disputes would occur between pipelines and customers regarding whether a tax was paid. This problem is acute at the entry point to the pipeline.

Almost one trillion cubic feet of gas goes into storage facilities and may not be consumed for as long as a year. Requiring the pipelines to collect the tax would result in significant timing problems. There is also gas that is needed for line pack to maintain the appropriate amount of pressure and gas flow in the pipeline and for cushion gas in a natural gas storage reservoir. This natural gas is never consumed. Paying the tax at an upstream point would tax gas that is not used as energy.

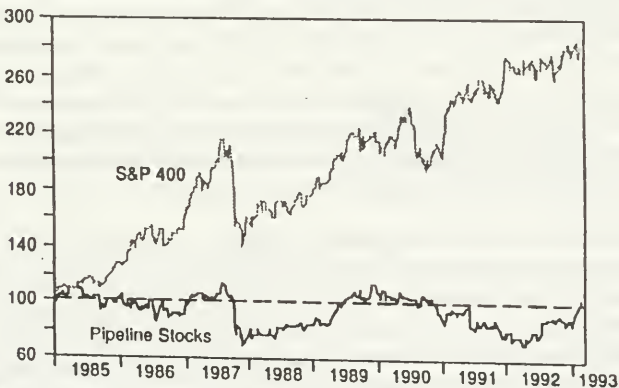
The natural gas industry has undergone significant changes in the last ten years. Interstate natural gas, all of which was subject to regulatory price control until 1978, is now decontrolled. The gas pipeline industry has been transformed from an industry which once owned all the natural gas it transported to one that will own none of the gas in its system. Each pipeline will also offer services which were originally "bundled," but now will be offered to transporters separately. The pipeline industry has also become very competitive. If the Btu tax is placed on the pipeline system and pipelines incur costs which they cannot pass on, this could result in lessening competition and adversely impacting the financial health of the industry.

Financial Health of the Interstate Pipeline Sector

From the perspectives of both debt and equity holders, pipelines cannot incur any costs that cannot be flowed through to customers. First, the equity perspective.

The first significant indicator of performance is a company's stock. Over the long term, pipeline stock prices have suffered from the move to open access. Pipeline stock prices have not grown as much as the S&P 400. The gap between these two representative indices is very wide.

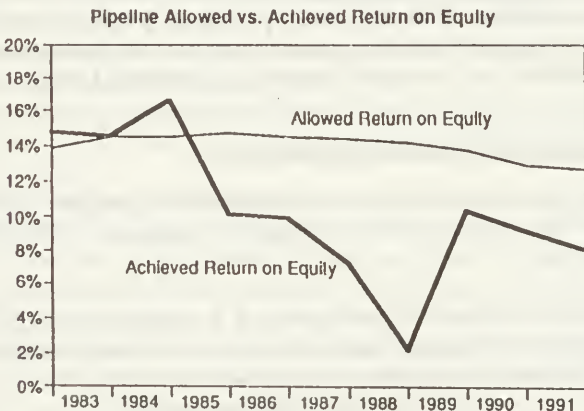
**Growth in Stock Prices
Pipeline Stocks vs. the S&P 400**



Source: INGAA, using data from Standard & Poor's Compustat

The recent improvement in pipeline stock prices has returned the index of pipeline stock prices to just above where it was at the beginning of 1985 (to 103 on the comparative scale used).¹ In contrast, the standard index of industrial companies, the S&P 400, has climbed steadily; it now stands at 282 on the comparative scale used. These indices mean that a dollar's worth of stock invested in the pipelines in 1985 would still be worth a dollar today, while a dollar's worth of stock invested in the S&P 400 would be worth \$2.82, almost three times more than the pipelines.

Return on equity is the second major indicator of how well a company is performing from an equity perspective. Return on equity indicates how much of a return pipelines have been able to earn on the funds that its owners have invested as equity.



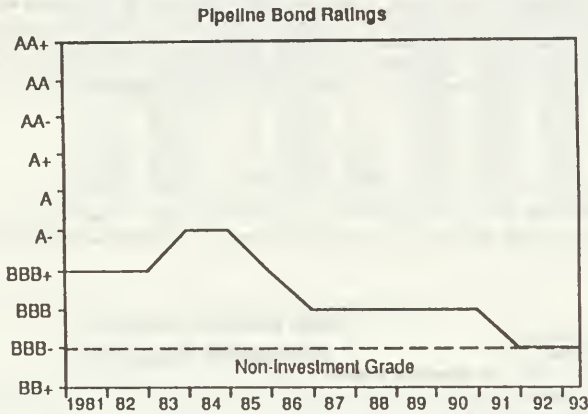
Source: Surveys of INGAA members

While allowed rates of return decided in rate cases before the FERC have gradually declined from nearly 15 percent in 1985 to just under 13 percent in 1991, actual earned rates of return have greatly underperformed the cutoff, falling from 10.1 percent in 1985 to 2.2 percent in 1988 and rising to only 8.1 percent in 1991.² Achieved return on equity has been well below that which has been allowed since the beginning of open access. While pipelines are not reaching the benchmark set by FERC, they are beginning to regain their financial health by this measure.

¹ The pipeline index is a simple average of the stock prices of the publicly traded companies for which 40% or more of both the company's income and assets are attributable to the interstate natural gas pipeline sector. The companies included are: AltaTerm Resources, Arkla, Coastal, Columbia Gas System, Enron, KN Energy, Panhandle Eastern, Sonat, Transco Energy and The Williams Companies. El Paso is not included due to its short trading history.

² These actual rates of return are a weighted average of return on equity as reported by 23 individual pipelines to INGAA.

However, the prospects are troublesome as measured by bond ratings on the fixed-income side. After plummeting from their high of A- in 1984, bond ratings, which reflect future financial health, remain depressed.³ At the end of February 1993, the average bond rating of the fifteen major interstate pipelines that are rated stood at "triple B minus" (BBB-), the lowest possible investment-grade rating.⁴ One more reduction would mean that, on average, pipeline debt would be primarily speculative, similar to a junk bond.



Source: Standard & Poor's Bond Guide

These ratings are an indication of fixed-income analysts' lack of confidence in the likelihood of pipelines being able to meet future payments of interest and principal.

While recent returns to equity holders have improved, pipelines have a long way to go to obtain the return on equity allowed by the Federal Energy Regulatory Commission. Fixed-income analysts have yet to change their very negative opinions of pipeline's ability to repay debt holders. From both the equity and the debt perspective, the financial health of pipeline companies is too tenuous to warrant that pipelines be subject to any costs that cannot be passed on.

INGAA believes that the BTU tax should be applied at the point of final sale for consumption because doing so will maximize the amount collected and because there is no other point from the wellhead to the burner tip which is free of problems of ownership, end-use or timing.

³ Bond ratings summarize how likely a company is to continue payments to its creditors. Fixed-income analysts give bond ratings from AAA to D based on the company's ability to repay interest and principal to the holders of its debt.

⁴ The average bond rating is the weighted average of the bond ratings of the following companies: ANR, Arkla, Colorado Interstate, Columbia Gas, El Paso, Northern Natural, Northwest, Panhandle Eastern, Quesstar, Southern Natural, Tennessee, Texas Eastern, Texas Gas, Transcontinental and Williams Natural Gas.

STATEMENT OF THE LARGE PUBLIC POWER COUNCIL

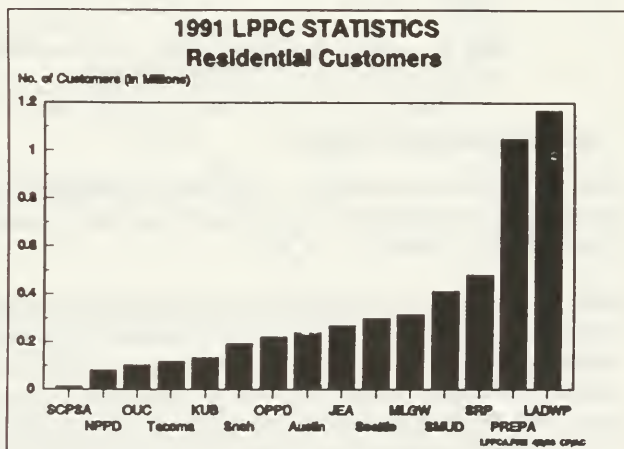
This statement is submitted on behalf of the Large Public Power Council in connection with the Senate Finance Committee hearings of April 20, 1993 on the Administration's proposed BTU tax. The Large Public Power Council (LPPC) supports the efforts of Congress and the Administration to reduce the federal budget deficit. We also support the related objectives of ensuring regional and consumer equity, energy conservation and preserving competitive relationships.

We are encouraged by recent modifications to the proposed tax, particularly those related to downstream collection points, accommodation of pumped storage, exclusion of coal used for gasification and imposition of the tax on independent power producers. However, we continue to have concerns about the manner in which the tax is administered and the point of collection of the tax. In order to ensure that the aforesaid objectives are met, and to provide an efficient, functional means of administration, the LPPC strongly advocates that the tax be designed in such a way to ensure that the ultimate retail consumer bears the tax.

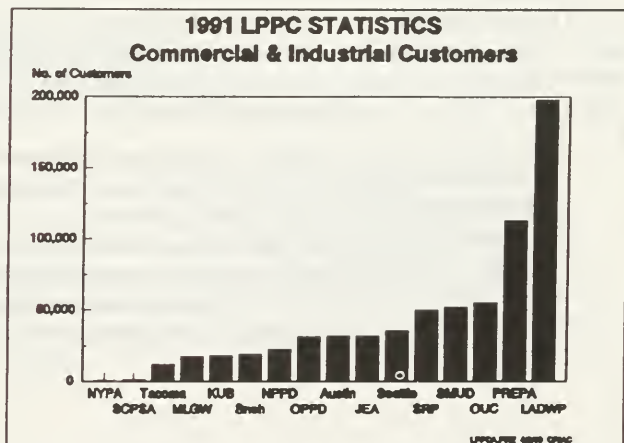
LPPC Background

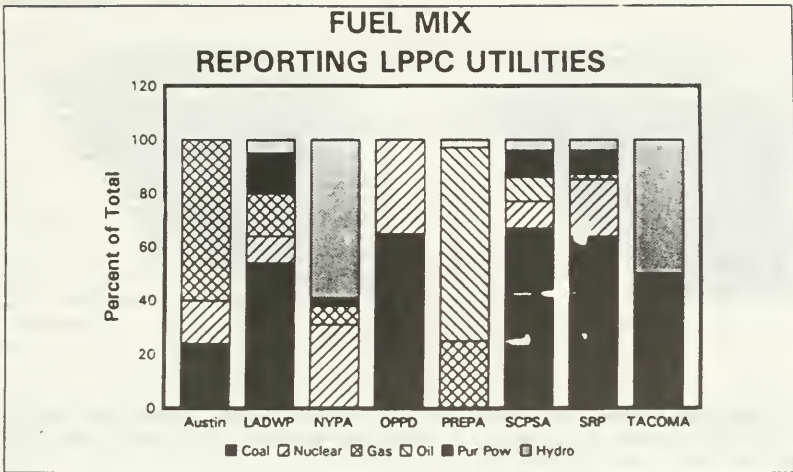
The LPPC consists of the 18 largest public power utilities in the nation. Most of us are constituted as municipal systems or political subdivisions. As such, we are owned by and accountable to the customers we serve.

Our membership possesses substantial geographic, resource, statutory and customer diversity. LPPC utilities serve predominantly retail customers and a substantial portion of the customers served by all local systems combined. As shown in the charts to the right, the LPPC serves almost 5.8 million customers; of this, almost 5.1 million are residential customers. The remaining customers consist of commercial and industrial customers. In addition, the majority of our members are involved in wholesale sales.



The resource reliance of our member utilities is diversified. Coal, nuclear energy, gas, oil, hydroelectric power, purchased power and some non-conventional fuels comprise our individual members' resource mix. The chart on the following page is representative of the resource mix of our members.





Implementation Concerns

As proposed recently in modified form, and with respect to electric utilities, the BTU tax would be imposed directly on the utility for electricity production using coal, natural gas, hydro and nuclear fuels. In addition, the proposal suggests a tax on floorstocks on the effective date of the tax and, presumably, on any incremental increase in floorstocks on subsequent adjustment dates. The tax would be passed through by the utility to the ultimate customer.

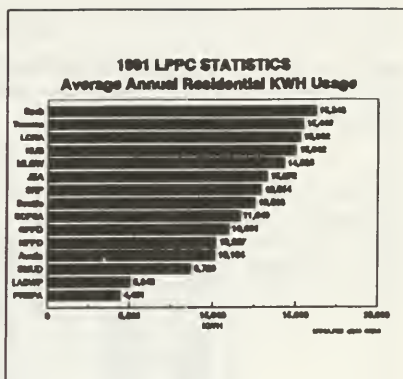
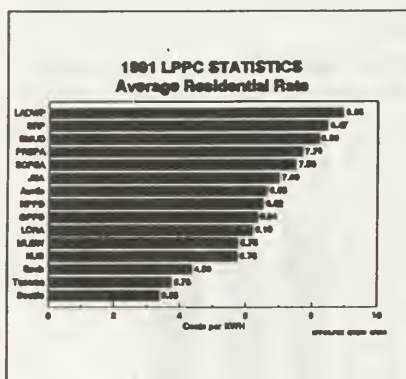
In materials presented before the Senate Finance and Ways and Means Committee on April 1, the Administration acknowledged that the energy tax should be allowed to be passed on to the end user and stated that it is considering methods to achieve this objective. The recent Administration modifications to the proposal are improved in that the tax is moved farther downstream in most instances. However, these modifications do not alleviate all of the problems associated with the pass through and administration of the tax. The examples which follow illustrate some of our concerns.

Equity Considerations

The energy industry today has become enormously complex. Energy suppliers and producers exist in multiple and diverse forms. The Administration has acknowledged that in order to ensure that the tax meets its principal objectives, it is essential that the legislation be written in a way to provide for equitable treatment of all sectors of the industry. The LPPC agrees that this is essential and supports the recent modification which explicitly subjects independent power producers (IPPs) to the tax. To ensure that the tax meets its primary objectives, it is extremely important that if enacted, the tax apply to all segments of the industry including investor-owned utilities, rural electric cooperatives, government-owned utilities (federal, state and local), and non-utility generators.

Similarly, we support the Administration's position that electricity purchased by the federal government be subject to the BTU tax. It would be our preference that the statute contain explicit and unequivocal language to this effect. Several of our members serve federal military installations that historically have strongly resisted rate increases. Were this to occur with the proposed BTU tax, our residential, commercial or industrial customers would be unfairly impacted.

The LPPC is also concerned that imposition of the tax results in regional inequities and regressivity. The charts below illustrate average residential customer rates and average annual residential customer usage for many of our members. Regional variations are clearly evident. Though the design of the proposed tax is intended to ensure regional equity, some electricity customers, particularly those in the southwestern and southeastern United States are characterized by higher usage and rates. Other areas such as the Pacific Northwest historically have been characterized as having low electric rates, but are facing significant rate increases over the next three to five years.



We would appreciate continued Administration and Congressional sensitivity to this issue in the design of the tax. The LPPC would be happy to provide any supplemental information and technical assistance in this regard.

It is also important to note that the economies of our service territories are affected by the existence of reasonably priced and reliable energy sources. Our large industrial and commercial customers are acutely aware of these costs, as they face tremendous and growing competition in the global marketplace. To the extent the BTU tax measurably increases the total cost of operations for energy-intensive customers, they may be forced to relocate to Pacific Rim or other locations, with resultant implications for U.S. employment and the economy. The LPPC strongly encourages Congressional and Administration sensitivity to these implications while ensuring equity in the application and administration of the tax.

Finally, the majority of our members engage, in varying degrees, in wholesale sales as well as retail sales. Some of these bulk power sales contracts contain price constraints which preclude pass through of cost increases to the wholesale customer. Again, this creates a disproportionate burden on the utility or on its retail customers. To alleviate this, the LPPC suggests that wholesale sales not be subjected to the tax. However, to ensure that the ultimate consumer is taxed, the wholesale buyer would be provided with the effective tax rate (based on fuel mix, heat rates and Kwh sales) by the seller, for use by the wholesaler in billing their customers.

Taking all of the foregoing equity factors into consideration, the LPPC believes that equity in assumption of the deficit reduction burden can best be accomplished by imposing the tax, through the means discussed above, at the retail customer level. This approach is further supported by practical considerations detailed below.

Fuel Adjustment

The conventional wisdom appears to be that a utility can easily pass the BTU tax on to its retail customers through fuel adjustment clauses or rate increases. However, this is not always the case. For example, in most cases, fuel adjustments require approval by our members' governing boards. Moreover, one of our members is limited in the number of annual adjustments to their fuel escalator and must secure approval for such from their state public utility commission.

There is now substantial pressure on utilities, indeed, on all businesses, not to increase rates. This is evident with several of our members where there are moratoria on rate increases. Generally speaking, our governing boards are much more hesitant to increase rates. Even under the most responsive of circumstances, the recovery of the cost is not immediate and thus, can have an adverse impact. In an environment characterized by increased competitive pressures and provision of the lowest cost service, it is absolutely essential that legislative language require pass through of the tax to the ultimate consumer. To avoid distortions in competitive relationships, with potentially deleterious effects, this pass through must be quick and efficient.

Having stated this, it would be the LPPC's strong preference that legislative language be drafted in a manner to assure that the tax is properly treated as a fuel cost adjustment thereby ensuring the utility's ability to recover the tax from the ultimate consumer through a utility's fuel cost adjustment clause, wherever applicable.

Tax on the Tax

The LPPC is also concerned that there be no layering of other taxes on top of the proposed BTU tax. The potential for compounding this tax increases the farther upstream the tax is moved. These compounding taxes include gross receipts taxes, royalties, severance taxes, franchise fees and sales taxes.

The LPPC suggests that legislative language specifically address this issue by precluding such compounding of the BTU tax.

Stockpiles

The recently-modified proposal preserves the notion of taxing fuel inventories or floorstocks. Our members object to this based on practical limitations and financial considerations.

The measurement of fuel stockpiles can be a complex, costly and lengthy process. As a result, many of our members conduct audits of their coal stockpiles every two years, which is the FERC requirement.

Taxing a coal stockpile at its BTU rate will typically require the use of outside vendors, who conduct a series of density samples, perform aerial surveys and apply statistical averaging. The entire process may take two to three weeks, and cost about \$50,000 for each stockpile. The aggregate cost to most electric utilities can be substantial, given multiple stockpiles. For example, one of our members maintains complete or partial ownership interest in six coal-fired plants and one nuclear plant. The cost of valuing these stockpiles is both complex and costly.

In addition, the carrying costs associated with fuel inventories is a sufficient disincentive to stockpiling fuels merely to avoid the tax. For example, a typical coal reserve is 30 to 60 days. In addition to the carrying costs, the administrative costs associated with valuing the stockpile on the effective date of the tax, and on subsequent index dates are not justified. Though business considerations probably would argue against it, a utility might seek to avoid this impact by completely eliminating their fuel inventories prior to the effective date of the tax.

Conservation

Consistent with the 1992 National Energy Policy Act, the proposed BTU tax will provide pricing signals to the consumer that encourage the conservation of electricity. The LPPC endorses this concept as many of its members are investing in "demand side" resources to offset their future energy needs. To maintain consistency, statutory language should explicitly endorse energy conservation and direct that federal regulations not discriminate against or provide any economic disincentive toward public investment in energy conservation measures.

Conclusion

In conclusion, the Large Public Power Council supports the efforts of Congress and the Administration to reduce the federal budget deficit. However, we believe that this and the objectives related to equity, conservation and competitiveness can best be served by imposing the tax on the ultimate consumer. Our members are prepared to provide officials with any necessary technical assistance and comments and we appreciate the opportunity to voice our concerns.

STATEMENT OF THE PETROLEUM MARKETERS ASSOCIATION OF AMERICA

Mr. Chairman, on behalf of the Petroleum Marketers Association of America (PMAA), I welcome the opportunity to testify on the proposed energy tax included in the President's economic proposal. PMAA represents more than 10,000 small, independent, family owned petroleum marketing companies.

PMAA has historically believed that the best way to reduce the federal deficit is to cut federal spending. The businesses represented by PMAA have had to streamline and continue to increase their efficiency. We believe the federal government should do likewise and we are disappointed that the President's economic recovery package fails to include greater levels of cuts.

However, we also recognize that even with steep budget cuts, additional revenue may be needed in order to bring the deficit back in line. To this end we believe the most appropriate tax increases are those that are applied across our entire economic system so that everyone shares in the additional tax burden. Historically we have opposed energy taxes targeted at deficit reduction because we saw no correlation between the amount of energy one consumed and that individual's contribution to the deficit. We still believe no such correlation exists.

However, this year, in recognition of pressing deficit concerns, the association agreed to consider a broad based energy tax that was applicable to all fuels at the same rate. In fact, prior to the State of the Union address, the association was taking the necessary policy steps to support the President's economic recovery package on the assumption that such a broad base energy tax would be part of that package.

Unfortunately, the Btu tax actually proposed by the President contains a supplemental tax on oil which is more than twice the rate of tax imposed on any other fuel. While this supplemental tax raises general concerns over the fairness and equity of taxing oil at twice the rate of other fuels, it also presents very specific and very substantial problems for our members.

We are pleased that the President has recommended that residential home heating oil be taxed at the uniform base rate of \$.257 per MBtu. We believe this lower rate is essential to maintain the competitive balance in the residential market for home heating oil. PMAA believes that the competition between oil, natural gas and electricity has been very positive for the American economy and consumer. Oil heat's efficiency has continued to improve and continues to lead both natural gas and electricity. Similarly, oil heat equipment burns the fuel cleanly and the Brookhaven National Laboratory has stated that the emissions profile for oil heat is on par with natural gas. Keeping the competition alive and heated will continue to benefit the American consumer and homeowner.

PMAA would note that there continue to be several questions with the President's proposal regarding home heating oil. Whether it applies to "non-residential" fuel such as what is consumed in a hospital, nursing home, apartment building, or school is uncertain, and we are hopeful that the Congress will ensure that these consumers of oil heat receive the same benefit as residential consumers. Further, we are concerned with whether kerosene and other oil products used for space heating will be subject to the same exemption. For example, kerosene is widely used for space heating in the south in individual burners, and is used in the northeast to aid in the flow of the fuel. We would encourage the Senate to not use the Btu tax to penalize particular classes of customers based on the type of oil they use or where they live.

Another source of strong concern to PMAA members is the impact that such a tax will have on farmers. PMAA members are primary suppliers of fuel for many agricultural communities throughout the country. The standard Btu tax will increase the cost of fuel three and a half cents per gallon, and the supplemental tax will increase the cost four and a half cents per gallon for a total increase of eight cents per gallon.

The American Farm Bureau estimates that for a typical corn farmer raising 430 acres of corn, the direct impact of these fuel costs will be \$550 per year. For the farmer, this may be a significant burden. Like every part of this country and nearly every citizen, the farm belt and its farmers have been harmed by the recession. Imposing another cost on this industry, above and beyond what other fuel users will have to pay, may slow the recovery in this important and vital industry and may affect their ability to compete in the international marketplace.

For the petroleum marketer who supplies the farmer, such a tax may substantially increase his accounts receivable, since in many cases the marketer may not collect the revenue from fuel sales during the planting season until after the harvest. This will place substantial new credit demands on both the farmer and the marketer.

If the supplemental tax is an environmental tax or is designed to reduce air pollution from automobiles and trucks, farmers should certainly not be responsible for paying for it. There is very little farming in Los Angeles, Chicago, New York and the other cities with severe air pollution problems. Most farmers are operating in areas defined by EPA as being in attainment of Clean Air standards, and their use of diesel fuel or gasoline does not create the type of air pollution problem that Congress addressed in the Clean Air Act. If a gasoline tax or an energy tax is an effective way of reducing air pollution, then the cities or regions with unhealthy air should levy the tax. A uniform federal tax makes too many people who live and work in rural areas pay for an urban problem.

The third major part of our customer base are truckstops and trucking companies. This tax will substantially increase fuel costs for these customers. Since, 1991, this industry has contributed two and a half cents per gallon for deficit reduction, a contribution unmatched by most industries. The proposed tax will increase the contribution by approximately eight cents per gallon. PMAA would note that the "just in time" delivery system has improved America's ability to compete, and that this system is largely based on the ability of trucking companies to deliver inventory needs on a very tight schedule at reasonable prices. We do not think that this industry should be singled out and required to again pay a bigger share to reduce the budget deficit.

Marketers also deliver substantial quantities of oil to small industrial users. Mining companies buy oil and lubricants from marketers for their truck fleets and also for the equipment they use in the mine. Lumber companies burn oil to dry timber. Construction companies use petroleum products for their dump trucks and cement trucks that use the highway, and for the bulldozers, cranes and frontloaders that work on a construction site. A substantial increase in price to mining companies may make their product less competitive with foreign imports. Lumber price increases will make homes less affordable, and an increase in construction prices may slow down the economy's recovery.

Finally, our biggest and perhaps most important customers are those who purchase gasoline for their own motor vehicles. Everywhere in the country, gasoline is used by private motorists.

We are deeply concerned that a tax of eight cents per gallons will substantially constrain their budgets, and believe that the more moderate tax which would result from a uniform Btu tax would be fairer to these customers.

PMAA believes that all fuels should receive equal treatment. Such treatment reduces the need for exemptions because no distortions will result from particular tax treatment. PMAA specifically opposes any exemptions from the tax for either ethanol or methanol. This tax is designed to raise revenue and reduce the deficit and thereby improve America's economic performance. Structuring a tax that provides specific benefits to industries or types of fuels undermines the revenue associated with the President's tax proposal and reduces the need to conserve. It also contributes to competitive imbalances in the petroleum marketing industry.

Ethanol currently receives a subsidy of sixty cents per gallon. A price subsidy roughly equivalent to the wholesale price of gasoline, less taxes. PMAA believes it is appropriate for the Congress to consider the appropriateness of the current subsidy, given that the current subsidy costs nearly \$500 million per year. Further, specific environmental goals addressed in the Clean Air Act have spurred markets for ethanol in 39 cities and the reformulated gasoline program now under development should provide additional market opportunities for ethanol. Providing an additional tax incentive for ethanol is therefore not appropriate.

Similarly, the proposal by the President provides LPG with the lower tax rate than petroleum, regardless of the feedstock. Under the current tax proposal this would provide LPG manufactured from petroleum with a four to five cent advantage over distillate. Since distillate and propane often serve the same use, it is unfair to provide an advantage to LPG.

PMAA strongly believes that the Btu tax should be levied equally on all fuels, and if the tax is modified to that end, it is likely that PMAA will not oppose such a tax. Deficit reduction is critical and is clearly in the national interest. However, differential tax rates on fuels are likely to result in substantial monies being wasted in the private sector as industries make investments to switch fuels to avoid a tax, rather than making the important investments which would reduce fuel use. These expenditures are non-productive, do not enhance productivity, and may in fact lessen our international competitiveness. We therefore strongly encourage the Committee to adopt a fuel neutral Btu tax.

PMAA also does not believe it is appropriate for the tax to be indexed. The Constitution vests the Congress with the taxation power, and even specifies that revenue raising bill should originate in the House. An indexation approach would vest within the Executive Branch the ability to determine what the actual tax rate will be, which we believe is an inappropriate delegation of authority.

From a policy standpoint, indexing is also unwise since it would allow the differential tax of oil, and all the problems associated with that differential tax, to grow. For example, had the tax been imposed five years ago and been indexed to the GDP deflator, the differential tax on oil today would be 41.2 cents per million Btu's, 7 cents higher than the current differential. Indexing not only locks in the differential, it exacerbates it.

Further, we are concerned that this tax may have many unintended consequences which will not be obvious until the tax is fully implemented. Allowing the tax to increase without Congressional oversight is therefore inappropriate. If the tax needs to be adjusted in three years, we believe that Congress should make the decision then as to how it should be adjusted.

At a minimum, if the differential remains in the final package, petroleum should not be subject to the indexing provisions thus allowing the competing fuels to gradually "catch up" with the tax rate on oil.

If this Committee does believe a differential tax on petroleum is appropriate, we strongly believe that heating oil and off-road users such as farmers should be exempt from the oil supplement. We do not believe that there are any sound economic or environmental reasons for an additional tax levy on oil heat customers or farmers. In fact, providing an exemption for oil heat and off-road users will simplify the administration of the tax in that it will be more similar to the existing tax structure. PMAA is confident that a tax system can be designed which can effectuate these exemptions without compromising the integrity of the tax and which may also improve the collection of the existing tax on motor fuels.

A final concern relates to how the tax is collected, and who should be responsible for paying the Btu tax. PMAA has been pleased to note that Treasury in its description of the modified Btu tax has indicated that the Btu tax will be imposed on petroleum products leaving the refinery. PMAA believes that this approach is superior to taxing the crude oil entering the refinery for a number of reasons, including trade policy and overall industry competitiveness.

However, we believe that there continues to be a number of issues that must be resolved and that should be considered by the Committee. As you know, the lighter petroleum products distributed by our members are subject to many federal and state excise taxes. For gasoline, the point of collection is generally the point where gasoline breaks bulk and leaves the terminal. For diesel, the point of collection is the producer level, and generally is the point where the product is identified as being for a taxable purpose or not.

The Committee is well aware that the collection of diesel and gasoline taxes has been plagued by fraud and evasion for many years. As a result, Congress has had to continuously revise the tax laws to stem these problems. Each change has solved some problems, and often created new problems. Unfortunately, we continue to receive reports that problems with taxation of motor fuels still exists, and we therefore would encourage the Committee to examine whether it might be appropriate to piggyback a Btu tax system onto an improved motor fuels tax system, rather than develop a new tax system for these products.

We thank you for providing us the opportunity to testify on this important tax proposal, and would gladly respond to any questions that you may have.

STATEMENT OF THE WASHINGTON PUBLIC UTILITY DISTRICTS ASSOCIATION

The Washington Public Utility Districts Association represents 22 public utility districts serving electricity to more than one and a half million people in the State of Washington.

We are greatly concerned about the method of computing the tax on hydropower, as proposed by the Administration, and urge your Committee to revise the manner in which the tax would be computed.

Members of this Association purchase more power from Bonneville Power Administration than any other group of BPA customers. Inasmuch as most of the power marketed by BPA is produced from hydroelectric generating facilities, the Washington Public Utility Districts Association has a major interest in policies affecting the cost of hydropower. Furthermore, several public utility districts own and operate major hydroelectric projects, including five on the main stem of the Columbia River.

We believe that the Btu value imputed for hydroelectric power has no basis in science, would discourage the use of hydroelectric power, would be detrimental to the economy of the Pacific Northwest, and would distort regional equity in the application of the Btu energy tax.

Scientific accuracy. As you know, the Btu tax on hydropower is based on the Btu input of an average fossil fuel electric generating plant—or 10,315 Btus per kilowatt-hour. However, this figure does not take into account that there is about a 90 percent efficiency in converting falling water into electricity, while there is only about a 35 percent efficiency in the conversion of coal-fired generation to electricity. Internationally recognized standards indicate that a kilowatt-hour of electricity has a heat value of 3,413 Btus. Taking into account the greater efficiency of hydropower production, the correct Btu value of a kilowatt-hour of hydropower is approximately 3,792 Btus. By basing the hydropower tax on the Btu input of an average fossil-fired generating plant, the Administration's proposal would tax hydropower at almost three times its Btu equivalency.

Impact on use of hydropower. The Administration's Btu tax proposal exempts renewable energy resources, but does not regard hydropower as renewable energy, despite the fact that hydropower represents about 85 percent of the United States' domestic renewable energy capacity. Nevertheless, we do not ask that hydropower be exempted from the tax, because the Pacific Northwest relies on hydropower for about 65 percent of its total generation of electricity, and we understand that all regions of the Nation should be covered in an equitable manner in the imposition of this tax. However, we do not believe that the Btu tax should discourage the use of the Nation's major source of domestic renewable energy. Yet, that could be the net result of application of the Btu tax on hydropower, as presently proposed.

Historically, hydropower has been an economical source of energy. However, Bonneville Power Administration is now faced with the prospect of a rate increase of much as 25 percent because of the cost of mitigating damage to fish, recent years of adverse water conditions, and other circumstances. If the Btu tax on electricity is applied in the manner proposed by the Administration, BPA estimates that an additional 12 percent wholesale rate increase would be required. An added rate increase of this magnitude could make the sale of some hydropower uneconomic, thereby forcing, among other things, increased reliance on natural gas, which is not a renewable resource. We believe it would not be sound national energy policy to substitute natural gas for a domestic renewable resource such as hydroelectric power.

Impact on industry. The economy of the Pacific Northwest is heavily dependent upon energy-intensive industries. For example, the cost of electricity represents about one-third of the cost of producing aluminum, 25–35 percent of the cost of electrolytic chemicals produced in the region, and 7–20 percent of the cost of pulp and paper. The large increase in the cost of hydropower which would result from application of the Administration's proposed tax would deal a serious blow to the Northwest's economy. The Northwest already is suffering from the layoff of 27,000 workers by Boeing, loss of jobs in the timber industry, and reductions in the workforce of other industries. The rate increase that could be triggered by application of the tax on hydropower could result in additional adverse impacts on the region's economy.

Regional equity. According to figures developed by the Washington State Energy Office, application of the Btu tax on all energy sources, as presently proposed, would result in an impact of \$137 per capita on the Northwest region, comprising the states of Washington, Oregon, Montana and Idaho. This figure compares with a national per capita impact of \$117. The impact on Washington State would be \$148 per capita. (We have defined the Pacific Northwest region differently than the Treasury Department and Department of Energy, which define the Pacific region as

including the states of California, Oregon and Washington. Inclusion of California in the region distorts the figures, and is not representative of conditions in the Pacific Northwest.)

According to the Washington State Energy Office, if the scientifically correct figure of Btus per kilowatt of hydropower were used, the regional impact would be \$114 per capita, which is about the same as the national average of \$116 per capita.¹ The Washington State impact would be \$122 per capita—or about \$6 per capita higher than the national average, because of climate, long driving distances, and energy intensive industries. Consequently, use of the scientifically accurate figure would bring the impact in the Northwest more into parity with the national average.

For the above reasons, we urge your Committee to revise the Administration's proposal by reducing the imputed Btu value of hydropower to the scientifically correct figure of 3,792 Btus per kilowatt-hour.

COMPETITIVE EFFECTS

Turning briefly to international competitive effects on U.S. industries, it is worth noting, as the table included in my testimony indicates, that industrial energy prices in this country are, and have been, substantially lower than those of our principal competitors in Europe and Japan. This has evidently not been a decisive competitive advantage for American industries, nor a competitive barrier to industries in Europe and Japan. On average for all manufacturing industries, energy costs equal about 2.5 percent of total production costs. Even if all the proposed taxes were passed forward from energy producers to industrial users and even if none of the increased manufacturing costs were passed forward from industries to consumers, the average manufacturer would experience a cost increase of one-tenth of one percent. This would have no effect on industrial competitiveness.

In fact, the US current account deficit has been largely a monetary phenomenon, arising fundamentally out of the need for large capital imports to finance domestic deficits. Macroeconomic simulations suggest that the tax increase, as part of a deficit reduction package, would reduce foreign borrowing and long term interest rates, and improve the current account balance by lowering the exchange rate. Since energy-intensive industries tend also to be capital-intensive industries, those sectors would gain from lower interest rates and a more favorable exchange rate, perhaps as much or more as they would lose from higher energy prices. It is noteworthy that bond and foreign exchange markets reacted in precisely this way to the announcement of the administration's economic proposals, providing a preview of coming attractions.

DISTRIBUTIONAL EFFECTS

With respect to incidence, it is fair to say that a broad-based energy tax is mildly regressive across expenditure classes to roughly the same degree as most other consumption or excise taxes. A VAT, for example, is regressive since it typically falls on a broad consumption base, exempting investment expenditures. Since much of the energy tax's effect on consumers comes through their direct residential and motor vehicle energy use, it offers substantial opportunities for tax savings. The price increases for end users—about 3 to 8 percent when fully phased in—can be offset by energy savings and conservation measures readily available to almost all households. For example, average fuel efficiency in automobiles could be improved by enough to offset 20 to 30 percent of the tax simply by keeping tires properly inflated.

EMPLOYMENT EFFECTS

A final point worth making is the relative impact of the energy tax on employment. The energy tax falls most heavily on the most energy-intensive industries, which are not by-and-large the most labor-intensive. Moreover, the energy tax encourages all firms to substitute other production inputs for energy use. This generally implies a substitution toward more employment. Consequently, one would expect that for a given amount of revenue collected, a broad-based energy tax would have more favorable employment implications than other alternatives. Given the

¹The data are from the federal Department of Energy *State Energy Data Reports* for 1990 (the latest available) as run on a computer program by the Washington State Energy Office. The data for Washington State reflect slightly higher levels for petroleum as a result of significant growth in Washington after 1990 whereas the remainder of the country saw no or negative growth in petroleum consumption.

concern over the slow rate of job growth in the current recovery, this distinction would seem to be significant.

CONCLUSION

To sum up, the most fundamental characteristics of an energy tax is that it is not a distortionary tax but potentially a corrective tax, and can be used to generate welfare gains by correcting for market failures. An energy tax fits closely into an overall stimulus and deficit reduction package. It is also a complementary measure within an overall energy strategy.

STATEMENT OF THE WASHINGTON STATE ENERGY OFFICE AND WASHINGTON STATE DEPARTMENT OF FISHERIES

The state of Washington supports a tax on the Btu content of fuels used for energy production, and the Administration's proposal is acceptable in nearly every respect. A single element of the proposal is greatly troubling, however, and if implemented, could cause significant environmental and economic injury to our state and region: the proposal to tax electricity generated from hydropower as if it were generated from fossil fuel. In our view, an adjustment is required on the merits, to ensure equity, and to promote consistency with environmental, economic, and international security goals.

Our first concern is that the application of the Btu tax proposal to hydropower is arbitrary and unjustified. A British Thermal Unit is an internationally defined unit of measurement. Hard and soft coals, for example, differ in Btu content, as do gasoline, diesel, jet fuel, and refinery gas. Electricity from hydropower also has a thermal value which can be easily measured. In the unique case of hydroelectricity, the Administration diverged from internationally agreed-upon standards and used a convention derived from DOE's State Energy Data Report (SEDR). This DOE report converts hydroelectricity into Btu's using the national average efficiency for fossil fuel generation. The justification is that this value more accurately reflects national energy use during droughts. It is not intended to measure the thermal value of hydroelectricity, but what might be burned instead if the hydropower were unavailable.

The notion of taxing hydroelectricity at this level makes no sense at all. It effectively taxes hydroelectricity's true thermal content at \$0.778 per million Btu's, more than three times higher than the \$0.257 level applied to coal, gas, nuclear fuel, and home heating oil, and thirty percent beyond the \$0.599 level applied to refined petroleum products. Policy reasons for the petroleum level are clear. Other adjustments to the tax have also been made:

- all renewables except hydropower have been exempted on policy grounds;
- any petroleum or natural gas converted into ethanol, methanol, MTBE, and ETBE to arguably gain air quality benefits has been exempted;
- any natural gas used to produce steam for tertiary oil recovery has been exempted.

We do not favor exempting hydropower from taxation, but there is no coherent policy argument for discriminatory treatment of a renewable resource.

Second, we believe adjusting the hydroelectric tax rate advances the Administration's explicit goal of regional equity without significantly changing federal revenues. It is our understanding that the primary purpose of the energy tax is equitable revenue generation. The Administration weighed the type of tax to be proposed and based its decision on considerations of equity, international competitiveness, and estimated regional impact. With the exception of the treatment of hydropower, we believe the tax generally meets these goals. With adjusted treatment of hydropower, we believe it would meet these goals more effectively.

For the average American, the difference between taxing hydropower at the proposed rate and its true efficiency is about \$1 per year, reducing overall collections from \$117 per capita to \$116. For the state of Washington, it would reduce per capita taxes from about \$143 per capita—fourth or fifth highest of any U.S. state—to within 1–2 percent of the national average. In evaluating regional impacts, Treasury Department testimony calculates below average impacts for the "Pacific" region—lumping Oregon and Washington in with California—which grossly distorts Northwest impacts.

Third, the proposed approach on hydropower would have negative environmental consequences, most importantly on the salmon runs listed under the Endangered Species Act. A high tax on hydropower would discourage the use of Northwest hydro facilities in a coordinated West Coast approach to energy and environmental protec-

tion. As our regional situation has shifted from an electricity surplus to deficit, due primarily to population growth, the Northwest (including British Columbia) has tried to substitute long-term electricity exchanges for outright sales. These offer the opportunity to move more water down the river in spring and summer to help salmon migration while displacing generation in mid-summer in California when air quality is worst. The generation is returned off peak, at night, during fall and winter to help fill our reservoirs and meet our winter needs. Both systems benefit environmentally and neither must build new generation to meet its electricity needs. This approach (and required Canadian involvement) would be strongly discouraged by a high fossil-based tax on hydroelectricity. The result would be development of new thermal generation in both locations, greater releases of CO₂ and other pollutants, and greater difficulty in adjusting to the need to provide higher spring and summer flows for salmon protection. Such a situation will result from any tax on hydropower that is higher than the tax on the most efficient alternative thermal resource.

There may be some who seek to discourage hydropower through the tax because, while a renewable resource, dams cause environmental damage. The difficulty is that disproportionate taxation will not change the way existing dams affect the environment. Disproportionate taxes will reduce BPA revenues, make more difficult provision of needed flows for salmon migration, and reduce funding for needed fish and wildlife investments. Reduced revenue will force BPA and other Northwest parties to defer, avoid, or short-cut vital investments in habitat improvement, hatchery operations, predator control, wildlife protection, and salmon passage—all necessary to comply with the Endangered Species Act.

BPA is currently negotiating with the Northwest Wildlife Coalition, which represents tribes, states, businesses, and environmental organizations, to spend many tens of millions of dollars on wildlife improvements in Washington. These and other critical investments may well be crowded out by rate pressures on BPA. Furthermore, improvements in output at existing dams—using more efficient turbines without any incremental environmental impact—would be discouraged. These resources are a significant element in the regional Northwest Power Plan. Any tax on hydropower that is higher than the tax on natural gas fired generation (about 7500 Btu/kWh) would discourage these investment relative to new carbon emitting gas generation.

Finally, unfair treatment of hydropower may have significant regional economic impacts. It has been our good fortune, in the Northwest, to be blessed with inordinate amounts of rain and rivers. The abundance of water has allowed us to develop extensive water based resources, including hydropower. This has allowed the Northwest to attract or sustain a large number of electricity intensive industries, industries which would be hard pressed to survive elsewhere in the U.S. This is not a measure of profligacy or environmental impact.

Ours is largely a run-of-the-river system; we cannot store significant quantities of water from one year to the next. We must release it at all times of the day and week for flood control, navigation, fish passage, irrigation, and other non-power uses. Much of this off-season, off-hour power is sold to aluminum companies, who manufacture about 40 percent of the nation's product and average more than \$1.3 billion in annual sales. Washington also employs some of the largest pulp and paper mills in the world. Our agriculture thrives because of pumped irrigation.

The Northwest is currently facing a 20–30 percent increase in BPA wholesale rates. This does not include either the energy tax or potential restructuring of BPA's Treasury debt. A further 10 percent increase from the proposed tax on hydropower could cause large increases in unemployment, significant loss of load—rather than conservation, and, potentially, lower federal revenues than would otherwise be the case.

The difference between taxing hydropower at the proposed fossil rate and at its true efficiency represents \$150 million per year for Washington industries and ratepayers. While rate increases are necessary, and Washington wants to contribute to deficit reduction, the unfair treatment of hydroelectricity comes at an extremely poor time. If implemented as proposed, the tax would strain the Administration's goal of not disrupting regional economies.

Among the negative environmental consequences would be a serious setback for one of the world's most ambitious electricity conservation programs already underway. While the expected rate increases may encourage conservation and force some industries abroad, they cannot in any way compare to the programs and experiments that BPA and the region's utilities have been able to run. BPA and the Northwest Power Planning Council expect to see \$7 billion spent regionally (\$4.5 billion in Washington) during the next 8 to 10 years in both public and private sectors for electricity efficiency measures. Many of these investments in the future will



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be crowded out by extreme rate pressure on BPA. Low-income citizens and programs are especially vulnerable. These customers do not have the resources to avoid the tax by investing in weatherization. Because weatherization programs tend to be high cost resources from the utility's point of view, they are extremely vulnerable.

Mr. Chairman, honorable committee members, we reiterate our strong support for the Administration's tax proposal. Our concern is not a fundamental argument against the energy tax. We are driven by two very practical concerns: That the high hydropower rate is unsupportable, damaging to effort to restore salmon runs and protect air quality, and that it will do significant damage to our economy. None of these are goals of the Administration or intended impacts of a Btu tax. We strongly urge the use of the international standard Btu valuation for hydropower, agreed to by the U.S. and other OECD nations, for treating electricity from hydro production for tax purposes.



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